

BRING
GOVERNMENT
BACK HOME

1944

HARLEY L. LUTZ

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Bring Government Back Home!

A PROGRAM FOR THE RE-ALLOCATION OF TAX
RESOURCES AND SERVICE RESPONSIBILITIES
BETWEEN FEDERAL AND STATE GOVERNMENTS

By

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FOREWORD

“OUR COUNTRY,” it has been written, “is too large to have all its affairs directed by a single government. Public servants at such a distance, and from under the eye of their constituents, must from the circumstance of distance, be unable to administer and overlook the details necessary for the good government of the citizens, and by the same circumstance, by rendering detection impossible to their constituents, will invite the public agents to corruption, plunder and waste.”

That was not written yesterday.

It is not a pronouncement of the National Association of Manufacturers.

It was written one hundred and fifty years ago by Thomas Jefferson.

It was true when Jefferson wrote it when we were only 21 states with a total population of about 5,300,000 souls.

It is more true today, when our borders encompass forty-eight great states and more than 150,000,000 people.

How strange that the American people — a people constitutionally jealous of its prerogatives and historically hostile to the idea of central government — have not seen central government entrenching itself deeper and deeper.

How strange that we have apparently been unaware of the progressive decline of local government and the proportionate mushrooming in the size and power of our federal government.

Big central government gets big by siphoning off the tax sources that should support local and state governments.

The end product of federal government domination of tax

sources is first the eclipse and ultimately the engulfment of all other levels of government.

Deprived of the sources of revenue to perform their proper functions, the states and localities become dependent upon the central government for grants-in-aid and thus wards of a guardian whose regulations and controls they cannot resist.

That will spell the destruction of the American system of local self government.

That will banish all hope of a return to the road which has thus far led these United States of ours to the highest levels of living standards, of individual freedom, individual prosperity and national greatness any people in all human history have ever known.

If we do not cut big government down to the relative size and shape the founding fathers intended — then government eventually will dominate our lives, destroy our freedom and kill the spirit of individual enterprise and initiative which has made America great.

Let's get government back home — back to the place where it was born — the place from whence it obtains its strength and the place where it can be made to serve the people instead of dominating them.

The plan that is proposed in this book is designed to restore the historic balance of power between central and state governments. This result is to be accomplished by transferring back to the states various service responsibilities which they can and should assume, and at the same time to provide them with revenue resources under their own control adequate for discharge of the duties assumed.

This plan and the underlying research is the work of Dr. Harley L. Lutz, Tax Consultant of the NAM and Professor Emeritus of Public Finance at Princeton University. The study was prepared for, and first submitted to, our four 1949 policy committees operating in the field of government finance. These four committees had an aggregate membership of 370, drawn from throughout the nation, and represent small, medium and large organizations. Upon the approval of the program by these committees, Mr. John Airey, Chairman of the Federal Tax Committee, Mr. Lane D. Webber,

Chairman of the Government Spending Committee, Mr. Wm. J. Grede, Chairman of the Federal Debt Management Committee, and Mr. Fred Bohen, Chairman of the Federal Subsidies Committee, presented the study to our Board of Directors and recommended its adoption. The Board took such affirmative action at a meeting on December 6, 1949 at which 114 members were present.

« In the interest of public service the study is hereby offered to the American people as a source of information on the concentration of governmental power and as a guide to the procedure for bringing government back home, where it can be seen more clearly, supervised more effectively, and where more adequate judgments of costs and benefits can be intelligently formed.

CLAUDE A. PUTNAM, *President*
National Association of Manufacturers

*“Ye shall know the truth, and
the truth shall make you free.”*

JOHN, 8.32

AUTHOR'S PREFACE

THE GENERAL PHILOSOPHY that is developed in this book regarding federal-state relations in the fields of taxation and service responsibilities has been simmering and evolving in the author's mind for ten years or more. Short articles were written on different aspects of the problem at various times and one of these was reproduced as an appendix to the work, *The American Individual Enterprise System*, by the Economic Principles Commission of the National Association of Manufacturers (New York, 1945). The developments of the postwar period produced a situation sufficiently critical to warrant a more complete exposition of the central thesis, which is that there must be a reallocation of *both* tax resources and service responsibilities between federal and state governments if we are to preserve the original constitutional design for an indestructible union of sovereign states.

Those who read this book are asked to judge it, first and foremost, on the basis of the principles of governmental reorganization proposed. For some readers there will be another question — Granted that the diagnosis and remedy are sound, can the plan be put into operation? This issue is secondary, for any program that is truly sound cannot be permanently defeated. To secure adoption will be an uphill fight, but such fights have been, and can be, won. The thirteen colonies took on a tough, uphill fight in 1776, and the new, weak Republic took on another such job in 1812. Each time the cause was right, and each time it prevailed. Above all, it is important to be sure that we are right in standing for a reallocation of resources *and* responsibilities as the way to preserve the American constitutional system and as the only sure bulwark against engulfing socialism.

The study has been done as a project of the Government Finance Department of NAM, and the four committees that were operating

in this area in 1949 were given opportunity to review such aspects of the program as fell within their respective jurisdictions, namely, taxation, expenditures, debt management, and subsidies.

The writing was done in a wholesome and stimulating atmosphere much like that of a well-run seminar. Many persons were of great assistance, but special acknowledgement is due to the following: John C. Davidson, Director of the NAM Government Finance Department, had the vision to perceive that the time was ripe for this undertaking. He has been a keen critic of the manuscript as it evolved, and an able administrator in handling the many details of its consideration by the various committees in the government finance area. Miss Jo Bingham, research associate in the Government Finance Department, wrote Chapter 9 and the Appendix. She also contributed excellent editorial judgment on the organization and review of the entire manuscript. Dr. Ralph Robey, Chief Economist of NAM, was a tower of strength in support of the project at the policy formation level. Joseph L. Borda, executive for the NAM Government Spending Committee, supplied many constructive comments and suggestions. Miss Dorothy Pivacek, administrative assistant to Mr. Davidson, had general charge of typing and proof reading. Miss Frances Goldberg, statistician in the NAM research department, did the computations necessary for the development of certain tables and statistical exhibits.

The author assumes full responsibility, however, for the text as it now appears.

HARLEY L. LUTZ
New York, 1950.

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CHAPTER 1

THE PROBLEM OF INTERGOVERNMENTAL FISCAL RELATIONS

Purpose

The purpose of this program is to establish a better balance of service responsibilities and tax resources between federal and state governments. The results which it will accomplish are: a better organized, more manageable, and far less costly federal government; fiscal independence for the states; and a material reduction of tax burdens for all citizens.

Premise

The federal government is too big. It is so big that it cannot be managed efficiently by any man or group of men.

The burden of its cost is now a greater load than the economy can carry and remain prosperous.

The steady pressure for more power to regulate and control is a growing menace to personal and civil liberty.

The increasing concentration of political power and economic control in the federal government is destructive of the economic and governmental environment which is essential to the survival of the American system of free enterprise and the preservation of the American constitutional system of a union of states.

Unless the trend toward big and ever bigger government can be halted and reversed, the states and private business alike face the prospect of ultimate complete domination by the federal government. And complete federal domination IS totalitarianism.

THE GROWTH OF FEDERAL POWER

The federal government has become so big it is a threat to free enterprise and to the sovereignty of the states under the Constitution. This threat comes from various sources, among the more serious of which are the following:

1. The steady rise, especially in peacetime, of governmental costs and tax burdens.

The overall cost of government in the United States today is about \$60 billion. It was \$2 billion in 1913. War, depression, emergencies, and war again have each in turn increased the cost, and scope, of government. But when each of these crises was ended, the level of government spending and taxing remained higher than it had been before the emergency began. Each time, on a larger base, the trend continued — upward. Each time, out of the whole burden on the citizens, the federal government took a larger share. And each time, government at the grass-roots withered. Look at the record:

	Total Tax Receipts	Federal Share	State and Local Share
1913	\$ 2.0 billion	33%	67%
1928	9.4 billion	36%	64%
1938	14.3 billion	41%	59%
1948	54.5 billion	74%	26%

From one peak of prosperity, in 1929, to another, in 1949, the expenditures of the federal government increased twelve times — from \$3.3 billion to \$40.1 billion. The 1949 volume of federal spending was \$6.3 billion greater than 1948; and expenditures for 1950 are expected to add another \$3.2 billion. This is a peacetime increase in federal expenditures of almost \$10 billion in *two* years.

2. A continuous further concentration of fiscal and administrative powers in the federal government.

There is no more convincing an example of money meaning power than that offered by the federal government. Individuals and states alike are tied to federal purse strings and bound by regulations. Federal money means federal power not only because of its volume, but also because of the number of different channels through which it is paid out in benefits, grants, salaries, and contracts. The Treasury lists 46 separate programs in which the federal government makes direct payments to states under what are described as "cooperative arrangements." By whatever name, in effect they constitute federal inroads on the independence of state governments. Federal aid to state and local governments was \$1.6 billion in 1948.

In the 1951 budget, the total is estimated at \$3.3 billion, more than double the "hand out" of 1948. Through such grants-in-aid, the federal government first stimulates, then supervises, and finally controls. The entire process has undermined the fiscal capacity and the administrative responsibility of the states. It has created a vicious spiral of larger federal aids, heavier federal taxes, and greater federal control.

3. A growing belief in federal beneficence, based on the great illusion that federal resources are inexhaustible and burdenless.

These privilege programs are the key to the consolidation and growth of federal political power, and the source of the notion that the bigger government grows, the more good it does. This idea is based on the illusion that federal money is free money, that federal grants and subsidies somehow relieve financial burdens, but cause none. Nothing could be further from the facts. The federal government has no resources other than those of the people. The money it gives out in benefits, it has first taken away in taxes.

And, contrary to popular supposition, these benefits are not mainly financed by "soaking the rich." Actually, only a small part of federal income taxes comes from the surtax rates; the bulk of it comes from the lowest rate — the basic, across-the-board rate on poor and rich alike. The benefits of big government are not a bargain, but a decided burden.

4. An acceptance of the doctrine that government spending and taxing on a substantial scale can support the economy and that, therefore, any material reduction of public financial activities would lead to economic decline and depression.

The fourth point is the logical outcome of the other three. The compass of the federal government has been confused with competence, and its heavy spending has been mistaken for support and maintenance. There is a widespread but mistaken belief that government spending *can* and does support the economy, that large-scale government spending insures prosperity.

There was a feverish activity that passed for prosperity during the war, when the gross national product was \$215 billion in 1945 and federal spending was \$100 billion. There was a closer approach to real prosperity after the war when gross national product was

\$263 billion in 1948 and the federal government spent less than \$34 billion. And there is prosperity even with gross national product down to \$255 billion, notwithstanding that federal spending is climbing toward \$43 billion. Increased federal spending does *not* maintain the status of the economy. Only the creation of real wealth can support an economy.

Government control is not synonymous with the public good; nor government spending with productivity; nor a managed economy with a prosperous economy. Government control is the shortest route from democracy to totalitarianism.

A BETTER BALANCED DISTRIBUTION OF FUNCTIONS AND RESOURCES

The movement toward the abyss of the totalitarian national state must be reversed. The most important action to accomplish such a reversal is to restore a proper balance between central and local powers and responsibilities. The original design of the constitutional system was that both the federal and the state governments should be strong and responsible, but that neither should ever become so powerful as to engulf the other. This design must be re-established. The measures to effect this end include the following:

1. Curtailment of the scope and the burden of the federal government, by:
 - a. Elimination of services, notably those inaugurated under depression or other emergency conditions which have now terminated.
 - b. Return to the states of various functions and services which can and should be handled by them.
 - c. Introduction of economy measures such as reorganization of departments and improved standards of federal departmental and agency management.
2. A realignment of taxation methods whereby the states may acquire the financial resources necessary to perform the services that may be assigned to them without the infliction of excessive tax burdens on the people.

Both aspects of the problem must be considered together. The

subject of overlapping or duplicate taxation by federal and state governments has received attention off and on over the last fifteen years. It has virtually always been approached in these discussions as if it were separable from the allocation of service responsibilities. These matters are not separable and no plan of revenue allocation can succeed unless it is accompanied by a parallel program of changes in the distribution of functions. By the same token, no proposal to shift important administrative tasks from federal to state jurisdiction can succeed without at the same time providing that the states shall have greater revenue resources for their own use.

The citizens are paying a heavy price in tax burdens for the top-heavy federal administrative structure, which has become far too large to be managed efficiently by any man or set of men. This burden can be materially lightened only by a substantial reduction in the scope and character of the services which the federal government is now trying, at such great cost, to perform. Reorganization of departments and agencies and other streamlining procedures are useful steps which would make possible some lightening of the tax load. The program accepts all sound proposals of this sort, for it is necessary to introduce much greater efficiency into federal operations than is now displayed. But more than reorganization is needed to achieve the maximum efficiency in governmental operation and the maximum reduction of the tax burden. This program makes that additional essential advance by indicating the service responsibilities which can and should be eliminated or transferred from federal to state jurisdiction. It is therefore a rounded whole, in which, for the first time in the long history of studies and discussions of the federal-state fiscal problem, there is presented an overall readjustment of both service responsibilities and tax resources.¹

SOME GUIDING PRINCIPLES

In approaching a task of this magnitude, there should be certain principles which would serve as guides to the procedures estab-

¹ For a resumé of these studies and reports, see the appendix document entitled *Review of Materials on Intergovernmental Fiscal Relations*.

lished and the objectives sought. The following principles are suggested :

1. In a country which seeks to retain free, popular government, service responsibilities should be performed by the smallest units competent to handle the several public services satisfactorily and economically.

The logic which supports this principle may be stated thus : The people as taxpayers must support the governmental services. It is their right as well as their duty to consider and pass judgment on these services and on their cost. The popular will can be more clearly expressed, and the popular control over public activities made more effective, the closer the officers in charge of public services are to those who must provide the support. Granted that the citizen interest in, and sense of responsibility for, efficient government are not as high as they should be, it is nevertheless true that a better response in these directions is possible in proportion as the matters to be dealt with lie closer to home.

This principle is violated by permitting the federal government to assume authority over matters which the states and/or their subdivisions can perform. It is common knowledge that the federal organization has become far too big to be organized competently or operated efficiently. And it is easily demonstrable that federal operation is more costly in many cases than it need be, or than state or local operation would be. Evidence of the inability to coordinate and control at the federal level is provided by the numerous examples of duplicate, or even of multiple, agencies that have been established to perform the same, or essentially similar, services. The impossibility of learning anything about the complex, remote federal organization, coupled with the numbing effect of a belief in inexhaustible, costless federal resources, has contributed much to the decay of citizen concern over governmental costs.

2. The areas of national interest and concern in which only the federal government can adequately serve the national good must be distinguished from other areas in which state, state-local, or private action constitutes as good, or better, a way of promoting the national interest.

There is too prevalent a belief that *only* the federal government

can promote the general welfare. The scope of its payments to people and its grants to states has fostered the idea that it requires federal action to support the economy and the people. Already some 19 million persons are reputed to be receiving from the federal government regular, direct payments — for salaries and subsidies, allowances and loans, for benefits, for services, for goods. Federal payments are already claimed to boost sagging segments of the economy through farm price-support operations, through the lending activities of the federal government — which are in effect concealed subsidies; and by various other federal business undertakings: writing insurance, guaranteeing mortgages, producing electric power, operating railways, irrigation operations, and numerous other activities.

In one respect it may be argued that whatever may be done, or left undone, may involve the national interest. But it does not follow that there should be federal assumption of financial or supervisory authority and responsibility in every instance, for this would lead to complete federal regulation of all business, and eventually, of all private affairs. As a general rule, stimulus and promotion, rather than administration or provision of services, are the areas where federal activity is most appropriate.

3. Taxation is necessary, but it is always burdensome, and it can be destructive. The dictum of Mr. Chief Justice Marshall should be held constantly in mind: "The power to tax involves the power to destroy."

This is nowhere more clearly indicated than in the instructions of Karl Marx that the way to establish communism is to destroy the private ownership of capital, and the way to destroy such ownership is to use heavy progressive income and inheritance taxes. The power to tax is truly the power to destroy — not only to destroy capital, business, and industry, but to destroy the states and cities as essential parts of the federal union, and ultimately to destroy the American constitutional system itself.

The use of the taxing power as an instrument of destruction may be inadvertent as well as deliberate. But in either case, those who commit such excesses have a tremendous responsibility for the future national well-being. No man, or group of men, possesses

such super-human knowledge of what is good or bad for national progress as to justify such action. Through taxation, in whatever amount levied, public decisions regarding the use of income are substituted for private decisions ; and through public spending there is the substitution of a public for a private market for goods and services. These substitutions constitute an interference with private economic incentives, and they should be held to the minimum consistent with the tax levies required for efficient performance of necessary public services.

Human nature being what it is, it is not possible to rely upon general philanthropic reaction to protect anyone against excessive or destructive taxation. All citizens become intensely individualistic here, and they protest against excess of taxation only when they are personally affected. The only effective restraint against the imposition of taxes at destructive rates is the existence of automatic safeguards against abuse. In the greatest degree possible, the tax system should be so arranged as to provide such safeguards. Their provision is an important advantage of the allocation of tax resources proposed in this program.

4. The tax base should be as broad as the interests to be served by the collecting and spending government.

In application, this principle means that federal taxes, which are levied to support services of genuinely broad, national concern, should be of a character such that they will fall upon all citizens and all sections. Instead of being so devised as to transfer income and wealth from one section or group to another, the amount and burden of the federal taxes should be so arranged and adjusted as to promote a normal growth of enterprise in all sections and a natural distribution of production and income through the operation of free market forces.

FEDERAL-STATE ALLOCATIONS

The present danger to American free enterprise and to American free government institutions is in the great size, power, and cost of the federal government. Unless the centralizing trend can be reversed, eventual federal domination of all business and all state and local government is inevitable. The allocations that must be

made, therefore, involve transfers of fiscal resources and service responsibilities from federal to state jurisdictions. This is not merely a nostalgic turning back of the clock. Rather, it should be regarded as a surgical operation which is vitally essential to the continued health and welfare of the patient.

The procedure followed here is to deal first with the allocation of revenues and then with the functional or service responsibilities, keeping always in mind the point mentioned earlier, namely, that both resources and responsibilities must be considered.

A Proposed Allocation of Revenues:

The allocation of tax resources essential to the success of this program involves fundamental changes in tax policy only at the federal level.

The purposes of these changes are to lighten the tax burdens of all citizens and to make available to the states and localities a more adequate share of total tax resources. *Then*, the separate states and localities could determine, with due regard to factors peculiar to them, the extent to which, and means by which it would be necessary to draw on these resources. It is a necessary condition of the introduction of this program that federal initiative to reduce spending and taxes shall precede state action to assume added responsibility and to increase revenue receipts.

In many instances, however, the availability of greater resources would make it easier for states and localities to improve their tax structures or avoid further introduction of unwholesome tax forms and duplications. Some of the factors involved in making adjustments at state and local levels are discussed in this program in order to illustrate the opportunities which would be provided for working out better intergovernmental tax relationships. But hard-and-fast conclusions are not drawn, recommendations are not made, and in no sense is there any intention to suggest that any particular state or locality introduce or increase any specific tax.

With this background, the following summary of the nation's intergovernmental tax structure is presented as an aid to understanding the significance of the major tax proposals included in this program.

BRING GOVERNMENT BACK HOME

INTERGOVERNMENTAL TAX STRUCTURE

Current Revenue Sources <i>Federal</i>	Comment	Recommendations, if any
<i>A. General Purposes:</i>		
1. Customs duties	1. Constitutional federal source	1. None
2. Alcohol and tobacco excises	2. See pages 58-61	2. None
3. Manufacturers', retailers' and miscellaneous excises (see next item)	3. See Chapter 3	3. Replace by manufacturers' uniform excise tax
3a. Admissions, entertainment, dues, safety boxes, coin devices, documents, bowling alleys (included in miscellaneous excises, above)	3a. See Chapter 5	3a. Reserve exclusively for local use
4. Individual income tax	4. See Chapter 2	4. Replace progressive rates with a flat rate, retaining present deductions and exemptions
5. Corporation income tax	5. See Chapter 2	5. None
6. Death and gift taxes	6. First used by states	6. Return to states
7. Payroll tax for unemployment compensation (.3 percent).	7. See pages 172ff, 262ff	7. Transfer of receipts in full to states
8. Miscellaneous nontax revenues	8. ———	8. None
<i>B. Trust account purposes</i>		
9. Payroll taxes for old age and survivors insurance	9. See Chapter 12	9. Change to pay-as-you-go
10. Railroad payroll taxes for unemployment and retirement	10. See pages 26, 163, 268	10. Transfer to trust accounts as deductions from receipts
<i>States</i>		
<i>A. General purposes:</i>		
11. Death and gift taxes	11. Traditional state source	11. Exclusive state use
12. Alcohol and tobacco excises	12. See pages 58-61	12. None
13. Gasoline tax	13. See Chapter 4	13. Exclusive state use
14. Motor vehicle licenses	14. ———	14. None
15. Retail sales	15. See pages 75, 76	15. None
16. Individual income tax	16. See Chapter 2	16. None

INTERGOVERNMENTAL FISCAL RELATIONS 11

Current Revenue Sources	Comment	Recommendations, if any
17. Business	17. Kind and extent varies by states	17. None
18. Severance	18. ———	18. None
19. Miscellaneous tax and non-tax revenue	19. ———	19. None
<i>B. Trust account purposes</i>		
20. Payroll tax for unemployment compensation	20. See pages 172ff, 262ff	20. States collect and manage receipts without transfer to federal treasury
21. Taxes and receipts for other state trust purposes	21. ———	21. None
<i>Localities (see also item 3a., above)</i>		
22. Property taxes	22. See pages 25-26	22. None
23. Retail sales taxes	23. See pages 75, 76	23. None
24. Income taxes	24. ———	24. None
25. Shared taxes	25. ———	25. None
26. State aids and grants	26. ———	26. None
27. Licenses and fees	27. ———	27. None
28. Miscellaneous nontax receipts	28. ———	28. None

The most important change from the present federal tax system is that proposed for the tax on individual incomes. This subject is discussed in Chapter 2. It is assumed that the states now levying taxes on individual incomes would continue to do so. It is possible that some others may elect to introduce this tax. Such action is not essential, however, for there are other ways by which the states can support themselves. The significant fact resulting from the proposed change is that reduction of the federal tax on individual incomes will make available greater tax capacity, which each state can draw upon in such manner as its citizens may prefer.

It is to be anticipated that some states would increase somewhat their rates of inheritance, or estate, and gift taxes, once this tax field is fully restored to them. Elimination of the federal gasoline and oil taxes is to be accompanied by termination of the federal highway grants. This subject is discussed in Chapter 4. There it is shown that except for the public domain states, for which special provision would be warranted on the ground of extensive federal ownership, additional revenue for highway purposes equal

to the federal highway grants could be provided by such tax adjustments as the several states may determine, at a net saving to highway users below the federal gasoline and oil taxes now being paid.

A desirable long-range objective would be to give the federal government exclusive use of liquor and tobacco taxes. State use of these taxes has developed so far, however, as to create complicated issues which will not be readily resolved. In lieu of the present selective federal excises, it is proposed to substitute a manufacturers' uniform excise tax on all commodities except food and food products, alcoholic beverages, and tobacco. The subject of the excise taxes is discussed in Chapter 3.

Finally, it is recommended that the whole group of federal taxes on admissions, amusements, safety boxes, coin devices, bowling alleys, and the stamp taxes, be reserved for local use. This involves state withdrawal to the extent that such taxes are now imposed for state use. These recommendations are dealt with in Chapter 5.

CONSIDERATIONS IN SUPPORT OF THE PROPOSED TAX ALLOCATIONS

An important question relates to the effects which the foregoing rearrangement of tax resources will have upon the ability of the federal and state governments respectively to carry the service responsibilities devolving upon them. This question is dealt with in the next section. Here it is proper that the program, as thus far developed, be tested by reference to the principles and major policy issues that were set forth above.

1. *Improved Financial Position of the States.*

A feature of the foregoing program which deserves and should have great emphasis is the contribution which it would make toward the restoration of the states as financially independent members of the federal union. The program therefore becomes highly important as a means of preserving the historic and constitutional intention of our governmental system. The states have come to be increasingly dependent upon the federal treasury for financial support through the vicious circle of rising federal taxes, shrinking base of

state taxation, and federal grants to supplement state revenues rendered ever more inadequate by the pressure of the high federal taxes. In the fiscal year 1949, for example, total state tax collections, exclusive of unemployment taxes, were estimated to be \$7,369 million. Direct federal grants to the states in the same year were \$1,835 million, exclusive of a small total of shared nontax revenues. Thus the states received, in the aggregate, grants equal to 25 percent of all taxes collected by them for general use. The increase of these grants to \$3.3 billion, as anticipated in the 1951 federal budget, could raise this proportion to some 30-35 percent. This represents a serious degree of dependency, and in view of the disposition of the federal government to establish compliance requirements of one sort or another as conditions of the grants, it indicates a growing extension of federal control over the policies of the states. They are being forced into a pattern which is being shaped for them by the central government. State authority, responsibility, and freedom to make independent decisions have suffered and will be further impaired as the degree of dependency increases.

The unbalance can be corrected and the states can be restored to a proper position of independent authority as sovereign members of a federal union only by providing them with larger revenues which are under their own control. As this is done they will no longer need federal support and they will no longer be subject to the seductive influence of federal programs which they may not need and certainly cannot control.

2. *An Automatic Safeguard Against Destructive Taxation.*

A second advantage of very great significance is that the plan is so arranged as to provide more or less automatic safeguards against excessive taxation in the areas where such restraints are now lacking. These areas are the individual income tax and the so-called transfer taxes on estates and gifts. The federal constitution sets no limits to the rates of these taxes and the courts would not interfere to set aside any scale of rates which the Congress might enact. Consequently, there is no upper limit to the rates that can be applied.

The proposal is that, in the case of the individual income tax,

the federal levy be confined to a flat or proportional rate and that the states which decide to tax individual incomes be free to apply such rates as they may severally determine. Here is the automatic safeguard. It is in the fact that no state will raise its scale of rates to an oppressive level because those who would be most seriously affected by such a practice would be free to migrate into a state that levied more moderate rates. The competition of the states would become an effective regulator of the rates that could be applied without too great danger of driving taxpayers out of the jurisdiction.

Similar logic applies in the case of the death and gift taxes. While there are now some difficult situations that have been created by court decisions with respect to multiple domicile, it would nevertheless remain true that no state could carry its taxes on estates or gifts to unreasonable levels. Confirmation of this position is provided by the action of the New York legislature in the 1950 session. Estate tax rates were reduced up to 29 percent, on Governor Dewey's recommendation, to prevent some New York citizens from transferring residence to other states.

In this way the income and transfer taxes would be safeguarded against severe exploitation in the same degree that now applies in the case of many other taxes. There are constitutional and legal safeguards which protect property owners against assessments greatly in excess of fair, or reasonable, or true market value, and ordinarily, there are constitutional or statutory limitations on the rate of property tax to be levied. Consumers can establish their own protection against excessive excise taxes by refusing to buy taxed articles, or by buying less, and they are usually able to control the timing of such tax payments.

3. *A Reduction of Overall Tax Burdens.*

The details of the tax savings that may be anticipated from the program are set forth in the following section. By way of summary here it can be said that an overall tax reduction of \$8.3 billions below the 1949 total is in prospect, even after allowing for the increases of taxation at the state level which would be necessary because of their assumption of added service responsibilities.

4. *Equalization between Debtor and Creditor Regions.*

The disparities of wealth and income among the states have frequently served as the principal ground for federal grants, whereby federal taxes are to be used to transfer income from one group or section to another. This approach to the problem is wrong in principle and futile in practice for it provides no incentive to correct the differences which may exist in the geographical distribution of wealth, industry, and population. Rather, it tends to perpetuate the differences and thus to perpetuate the grant system.

Too little attention is commonly given to the principal reason for the relative disparity of wealth and income among the states. This major reason is the lack of capital in some areas. There is no state and no section of the country which is seriously deficient in all natural resources. On the contrary, every section possesses such resources of some kind or other. In every section there is a virile, industrious population. The development of these natural and human resources would provide better employment, greater production, and higher incomes for the people living there. The lack, or slow rate, of such development must be ascribed chiefly to a deficiency of capital.

The heavy federal income taxes constitute a serious barrier to the provision of the needed capital and to its investment in the economically backward areas. Risks would be greater there but these taxes make no allowance for exceptional risk. Their sole criterion is size of income, and at the present rates they carve away such large slices of income whenever and wherever it is received as to leave little of either capacity or incentive to invest. The tax plan proposed here will remove this barrier and will make possible both a greater accumulation of capital funds in the aggregate and a greater diffusion of their investment throughout the country.

Such diffusion will not injure the states which now have the bulk of capital concentration. For one thing, the tax burdens of their own residents will be eased and more of the fruits of thrift and effort can be retained. Further, they will not be obliged to see a substantial part of their tax payments siphoned off into other states for the support of services there. And finally, the growing prosperity of other regions will create better markets for producers everywhere.

EFFECTS OF THE PROGRAM ON FEDERAL REVENUES AND EXPENDITURES

The Federal Revenues.

The receipts from the taxes proposed here for federal use will naturally vary with general business and economic conditions, which is true of the present tax system in even greater degree. In the following tabular summary actual collections for the fiscal year 1949 are shown, and in another column the amounts proposed to be raised under each tax recommended for federal use are indicated. The year in which the program outlined here could first conceivably be introduced in its entirety would be several years hence, and the fiscal period of initial operation is therefore identified as 195X. The receipts shown for 1949 include only those federal taxes which are comparable with the recommended future federal tax system.

TABLE I
ACTUAL FEDERAL RECEIPTS, 1949, AND PROJECTED RECEIPTS
UNDER THE PROPOSED PROGRAM, FOR GENERAL PURPOSES
(Millions)

	Fiscal Years 1949	195X	Savings or *Increase
Tax receipts (net of refunds) ^a			
Individual income tax	\$16,352	\$ 9,000	\$ 7,352
Corporation income tax	11,140	9,000	2,140
Excise taxes			
Alcoholic beverages	2,168	2,300 ^b	* 132 ^b
Tobacco and tobacco products	1,322	1,400	* 78
All other excises (1949) and manu- facturers' uniform excise tax (195X)	4,013	4,000	13
Customs	367	500	* 133
Estate and gift taxes	778	—	778
Federal unemployment tax (.3 percent)	223	—	223
Total taxes for general purposes	36,363	26,200	10,163
Miscellaneous receipts	2,072	1,750	322
Totals ^c	\$38,435	\$27,950 ^b	\$10,485 ^b

a. Individual income tax refunds reported as paid in the fiscal year 1949 were abnormally large because of the special situation produced by the Revenue Act of 1948. The tax reductions authorized by this Act were retroactive to January 1, but the new withholding tables did not become effective until May 1. In consequence, there was substantial excess withholding during the first four months, and some excess payment in the March 15 declarations. These abnormal collections would properly be chargeable against income tax receipts of the fiscal year 1948. Final adjustment and refund did not occur, however, until after the close of the taxable year 1948, which threw the actual payments into the fiscal year 1949.

In order to present a more realistic account of the individual income tax liability in the fiscal year 1949, the reported refunds have been adjusted to an amount estimated to be properly chargeable against that year's tax receipts. The adjustment was as follows:

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Actual individual refunds in 1948 were \$1,700 million. An average of corporation income tax refunds in 1948 and 1949 was \$471 million. The budget estimate of total refunds in 1950 is \$2,245 million. Other refunds of internal revenue taxes were \$76 million in 1949. At the same rate for 1950, the budget estimate for refunds of income taxes in 1950 becomes \$2,169 million. Deducting corporation refunds on the basis of the average for the years 1948 and 1949 leaves \$1,698 million for individual tax refunds. Hence, on the basis of actual 1948 figures and this calculation of the budget allowance for 1950, it is assumed that \$1,700 million would be a reasonable amount to assign as the refunds made against individual income taxes collected in the fiscal year 1949.

- b. If the Congress should meantime repeal the last war tax increases, this yield would be some \$575 million less and the totals indicated would be reduced accordingly.
- c. Excludes payroll taxes for railroad retirement and old age and survivors insurance.

In Chapter 2 there is a discussion of the rates which would probably be required to produce the amounts assumed to be collected under the income taxes and the manufacturers' uniform excise tax. At present national income levels, these rates would be about as follows:

Individual income tax flat rate of 11.2 percent would produce \$9 billion.

Manufacturers' uniform excise tax rate of 5 percent would produce about \$4 billion.

The corporation tax rate would probably have to remain at the present figure unless profits held at high levels. It would require taxable profits of \$23,684 million to produce tax revenue of \$9 billion at 38 percent. The average profit for the years 1945-1949 was \$27,400 million. A standard tax rate of about 33 percent would produce the required revenue on this volume of taxable income.

From the standpoint of affording adequate leeway in taxation to the states to enable them to assume the service responsibilities allocated to them, the most important aspect of the proposed revenue shifts is that in the individual income tax. The federal rate levied on individual incomes should always be moderate and proportional. If exceptional circumstances should at any time require that some increase of federal revenues be provided, this should be accomplished by adjustments in the rate of corporation income tax or in the rate of manufacturers' uniform excise tax, rather than continuance of any progression in the individual income tax at the federal level.

It should be noted that the proportions of federal revenue to be obtained from the major federal taxes can be varied somewhat and that the particular distribution shown in Table I is not a hard and fast requirement essential to the success of the program. The one

variation that should not be used would be a substantial increase of individual income tax in order to effect tax reduction elsewhere. The reason is worth emphasizing again — “take-home” income must be increased everywhere to enable all states to finance their own part of the governmental job.

The Federal Expenditures.

The necessary expenditures of the federal government under the proposed program will depend upon the range of services to be performed and upon the standard to be observed in their performance. It is entirely clear that there must be a substantial reduction in the range of services if there is to be a material reduction of the federal tax load. Observance of the principle that the proper sphere of federal action includes mainly the public services of nation-wide concern, to which a corollary would be that matters involving local, regional, or sectional concern should be regarded as within the area of state action, would call for transfer to the states of various activities now in the federal domain, and the discontinuance of others, with discretion in the states to assume them or not. And the often forgotten principle of economy, which teaches that the national interest can never be served by the wasteful use of income or resources, provides the warrant for the most efficient reorganization of the federal administrative structure that can be devised.

As a prelude to consideration of what the federal government must spend, the following changes of federal policy are proposed:

1. Elimination of federal grants-in-aid and transfer to the states of full responsibility for the services which they now administer with such aids.

The case for these grants has never been impregnable in view of the immense additional burden on a number of states beyond the amounts which they receive as grants, and in view, also, of the demoralizing sense of dependency which must be experienced by states that receive grants in excess of the cost to them. The release of substantial tax resources to all of the states under the program proposed here would go far to remove all grounds for a continuance of the system. Moreover, it would put federal-state relations on a more wholesome basis by dispelling the illusion that money received

from the federal government is in some way free and costless. The states, being put on their own responsibility, might not severally adopt all of the programs now supported by federal grants. This should be their privilege, and a local judgment would in some cases be more reliable as to the need and value of the services than one formulated by the central government and "sold" to the states with the lure of a grant-in-aid.

2. The curtailment, and in some cases, the complete elimination of federal subsidies to sections and groups.

While the federal subsidy, in one form or another, is a very old device, it attained large proportions only with the onset and deepening of the depression of the 1930's. At that time the national income was less than \$50 billion, and this form of federal aid was deemed to be justified by the current economic distress. Instead of being discontinued as the economic situation improved, the subsidies have been retained and greatly expanded in cost, despite the rise of the national income to more than \$200 billion.

This experience emphasizes the weakness of the subsidy approach. It is a kind of economic shelter or protection which is intended to deal with some bad or undesirable situation. It never corrects that situation, nor can it ever provide any sort of incentive among those affected to correct it. Once introduced, it usually becomes perpetual because it has merely covered and hidden the sore spot but has not cured it. Subsidy money is another form of easy money, and, as in the case of the grants, all parties concerned are likely to regard it as costless and burdenless simply because it comes from the federal treasury. As the record shows, the amount that can be spent in this way can pile up a huge total.²

3. Elimination of federal lending and similar operations in competition with private business.

The multiplication of federal lending agencies has become notorious, and there is no effective way of measuring the extent of their competition with each other as well as with private business. In view of the number, variety, and financial strength of private institutions at the present time, the only case for federal participation

² See Chapters 4 and 5, and Table XXXVIII.

is that it provides a means of extending a direct or indirect subsidy through favorable interest rates, terms of repayment, or other concessions. These concessions add up, however, to a greater tax load on the economy.³

4. Elimination of federal expenditures of every sort which are designed to support or control the economy.

It is time that we abandon the delusion that there is some special virtue in public spending which does not inhere in private spending. Government cannot support the economy by taxing away private incomes and spending the money on projects of its own devising. Government can over-stimulate the economy by inflating credit on a substantial scale, but such a policy undermines rather than supports.

5. Reduction of the direct and indirect costs of personnel as the scope of federal services is curtailed, and the introduction of a policy of operating the services which are to be performed at the federal level efficiently and economically.

After these preliminaries, which are intended to indicate the viewpoint from which the federal budget is approached here, a summary outline of the federal spending deemed to be necessary under this program is given. As explained above, the outline is projected as a budget for 195X, in recognition that a certain period of time will be required to give effect to the program. The data are organized according to broad functions, within which the various governmental units are classified according to the major emphasis of their service operations.

*War-Connected Costs.*⁴

In 195X, it is reasonable to anticipate that the war-connected costs would decline from their present levels because of the disappearance of readjustment benefits to veterans and of the commitment to support foreign countries in economic rehabilitation programs. Consequently, even if there should be no more than a moderate decline by that time in the cost of the military establishment, the summary of war-connected costs should be somewhat as follows:

³ See Chapter 11.

⁴ This subject is discussed in detail in Chapter 10.

TABLE II
WAR-CONNECTED COST IN 1949 AND 195X
(Millions)

Class of Expenditure	Actual 1949	Proposed 195X	Savings or *Increase
Veterans	\$6,723	\$3,387	\$3,336
Interest on war debt	4,611	5,000	* 389
National defense	12,502	12,379	123
Foreign aid: occupation costs	6,387	—	6,387
Total, war-connected costs	\$30,223	\$20,766	\$9,457

The item, "Interest on war debt," represents an allocation based on the portion of the federal debt deemed to have been issued for war purposes, as explained in Chapter 6. It is assumed that the total interest charge on the debt will rise somewhat under debt management policies that will point toward easing of pegged interest rates and refunding of bills and certificates into longer maturities. The remainder of the total interest item is carried in the nonwar costs.

Nonwar Costs.

A summary of the nonwar costs is given in Table III.

TABLE III
NONWAR COSTS IN 1949 AND 195X
(Millions)

Class of expenditure	Actual 1949 ^a	Proposed 195X	Savings
Framework of Government	\$2,237	\$1,500	\$ 737
Promotion and Supervision of Business and Economic Activities	1,122	500	622
Conservation and Development of Natural Resources	2,003	1,031	972
Social and Economic Welfare	2,344	474	1,870
Government Business Enterprises	1,840	1,000	840
Total, nonwar costs	\$9,546	\$4,505	\$5,041

a. Reconciliation with budget total of expenditures in 1949.

Budget total

\$40,057 million

Deduct, to adjust to Treasury Daily Statement

272 "

Actual expenditures, after adjustment

39,785 "

Total, from Tables II and III

39,769 "

Difference, from rounding

16 "

The details in support of the estimates for 195X are developed in later chapters.⁵ Important among the reasons for the substantial decline of projected expenditure for economic and social welfare is the treatment of the railroad payroll taxes as a deduction from receipts, in accord with the current treatment of the OASI payroll taxes, rather than as an expenditure. This is discussed below in the chapter on the federal trust accounts.⁶

Thus it appears that a federal budget of approximately \$25 billion would be possible in 195X, made up as follows:

War-connected costs in 195X	\$20,766 million
Nonwar costs in 195X	4,505 million
Total	\$25,271 million

It should be noted that reduction to this level would be accomplished in part through the re-allocation of service responsibilities and tax resources, and in part through the termination, as time passes, of certain obligations which now contribute to the current extraordinary federal costs. It is true that the gains of the latter sort could be expected to bring down the future budgets even without the extensive readjustments proposed here. But the recent experiences with the federal budget reveal that there is faint prospect of realizing such gains under the existing tax and expenditure structure. Rather, there is far more likely to be an expansion of old and new programs for grants, subsidies, and other services, and the retention of the serious unbalance which now prevails in the distribution of tax resources would provide an ever stronger reason for additional federal support. There is only one way to get full advantage from the normal decline of the extraordinary federal obligations, and that is to push through a full dress readjustment of taxing power and spending obligations such as is proposed here.

STATE AND LOCAL REVENUES AND EXPENDITURES

From the state standpoint, the key principle of this program is the release of a sufficient volume of tax resources to the states to render them independent of federal support, and to permit assump-

⁵ See Chapters 6-9 inclusive.

⁶ Chapter 12.

tion by them of services and activities which are in essence local responsibilities. The program emphasizes reversion to the historic concept of our government as a union of states, in which the several states have large areas of sovereignty. The maintenance of a federal union always involves careful concern for, and attention to, the problem of balance. If the states become too strong, the union is weakened and may fall apart; on the other hand, if the central government becomes too strong, the states will lose all power of independent action and become mere provinces. Historically, the pendulum has swung back and forth, and at the present time it is much too far toward the side of central power. There must be a restoration of a reasonable degree of states' rights and responsibilities if we are not to abandon the historic concept.

The spendable cash resources of the states now include the funds obtained from their own taxes and those provided as grants by the federal government. It is essential to the restoration of state authority and responsibility that they be given access to a volume of taxable resources sufficient to perform their own functions and services without federal assistance. The federal grant system should be eliminated, except for moderate amounts of highway aid to the public domain states which are still sparsely settled and relatively undeveloped, and in which the federal government owns a large proportion of the area.⁷

Regardless of current protests and policy declarations to the contrary, it is indisputable that there is no permanent protection of the grantee government against control by the grantor government as a condition of continuing the grant. When the grant system has become so important to the states that they cannot afford to stop it then they will have sacrificed all opportunity of resisting the accompanying controls. It was noted above that the states are now receiving federal grants which total upwards of one-quarter of the revenues which they obtain through their own taxes. Already they are dangerously close to a fixed and permanent relationship of benefactor and mendicant. Such a relationship is always demoralizing to both parties, even when it is based on the purest of philanthropic motives. When it becomes, or is capable of becoming, a

⁷ See Chapter 4.

source of power to be exercised by the benefactor over the dependent, it assures the permanent subjection of the latter. No state need be, and none should be, permanently dependent for financial support upon the federal government, which has no resources either for its own proper purposes or for giving away except those taken from the people. This program aims at leaving enough financial resources with each state to render state mendicancy wholly unnecessary.

A tentative balance sheet of additional state expenditures and revenues under the proposed program would be as follows. It is indicative only, and is not to be regarded as a recommendation.

TABLE IV
ESTIMATED ADDITIONS TO STATE AND LOCAL BUDGETS
UNDER RE-ALLOCATION PROGRAM
(Millions)

Potential Savings (from Table I)	\$10,485
Additional Expenditures : ^a	
Highways (to equal federal grants)	450
The public assistance categories (OAA, ADC, AB)	1,000
Education (to equal grant proposed in S.246)	300
Airports (Municipal share)	75
Other grants	400
Total additional expenditures	\$2,225
Additional state and local revenues	
Highway use taxes, to yield	\$450
Admissions, etc., to yield	300
Estate and gift taxes (net increase)	350
Payroll tax for unemployment compensation	225
Subtotal	\$1,325
Balance, to be obtained by other tax methods	\$ 900
Net savings	\$8,260

a. The data relating to additional state expenditures involved in assuming responsibilities to be allocated to them are for the year 1949. Federal budget projections indicate that plans are already under way to expand the volume of federal grants to as much as \$3.3 billion in 1951. This process of expanding old programs and adding new ones will erode the net tax savings to the people, increase state dependence on federal grants, and diminish the prospects for a thorough re-allocation of functions back to the state level.

Improvement of the fiscal position of the states would come through relinquishment to them of certain federal taxes, as suggested above, and through a substantial reduction of the burden of the federal income tax. It should be emphasized again that there is

no intention to suggest, and no obligation on the part of any state to accept, a tax on individual incomes or to make any other specific tax changes. In 1949 taxes were levied on individual incomes, or on designated forms of such income, notably from investments, in 33 states, the two Territories, and the District of Columbia. In six states the rates were not graduated. That is, 27 states, the two Territories, and the District of Columbia are now making use of the progressive principle, but the degree of progression is moderate in most instances. State receipts from individual income taxes in 1949 were \$575 million. Whether the revenue from this source is increased, once the barrier of the federal progression is removed, would be a matter for the determination of the several states.

All of the states except Nevada now impose taxes on the transfer of property at death. For obvious reasons, the states are now limited to the maximum established by the 80 percent credit against the federal estate tax as determined according to the federal act of 1926. Thirty-nine states now levy a supplemental estate tax designed to supplement their own rates, whether of inheritance or estate tax, in order to take full advantage of the 80 percent credit provision. In addition, thirteen states impose gift taxes. Total state collections in 1949 from these taxes were \$179 million, as compared with \$778 million by the federal government. The additional state revenue from this source that is suggested in Table IV is about double the present return, an amount that could be obtained without the imposition of excessive rates.

Local Finances.

The finances of local units would be improved in various ways. The taxes on admissions, entertainment, club dues, safety boxes, coin devices, and the like are well adapted to local administration. Even if these taxes were to be levied locally at rates below those now imposed by the federal government, they would provide substantial revenues in the larger cities, which are usually most hard pressed. This subject is dealt with in Chapter 5.

The elimination of the surtax feature of the federal income tax would improve the value of real property, which will no doubt continue to be the mainstay of local tax revenues. This improvement will occur, in the case of income property, through the fact that there

will remain a larger net income, after taxes, to the owners of real property than is now left to them. The value of such property is determined, in unique degree, by capitalization of the net return and as the return is enhanced the capital value will rise. Reduction of the burden of the federal tax would have the same effect as a rise in rents, but it would not be, like a rent increase, a threat to steadiness of occupancy.

Reduction of the federal income tax burden will lead, indirectly, to an increase of assessable values of real property used for owner occupancy residential purposes. As individuals acquire control of more of their income for their own uses, many will apply part of this income to the ownership of better types of residence than they can afford under existing taxes. The effect of these taxes in undermining high value residential sections can be observed in many places. Income tax reduction will reverse this process and lead to an improvement of residential property values.

THE TRUST ACCOUNTS

The subject of the federal trust accounts is dealt with in Chapter 12. No separate studies have been undertaken of the numerous state and local trust funds, the aggregate of which would not be large by comparison with the huge amounts that have been accumulated in the federal trust funds.

The Federal Trust Accounts.

In the allocation of tax resources which was proposed above, the payroll taxes for unemployment compensation were assigned to the states, and complete responsibility for the custody and administration of these funds in future was proposed as a state function. There would remain, as a federal responsibility, the collection of the payroll taxes levied for the old age and survivors benefit system, and those collected under the separate system applicable to the railroads. It is recommended that the railroad taxes be transferred immediately to the trust accounts as a deduction from receipts, in accord with the practice that has always been followed in the case of the OASI taxes. Retention of these taxes in net receipts and inclusion of their ultimate transfer to trust accounts as an expenditure results in an unnecessary inflation of both sides of the budget.

With respect to cradle-to-grave security proposals which are being urged upon the federal government by special interest groups, it should be said that these issues have been dealt with thus far entirely on an emotional basis, with little or no attention to factual, objective considerations. The extent to which a long-range governmental program to provide benefit payments in case of sickness or disability would prove to be advisable or necessary must be evaluated in the light of the shifts in tax resources and economic capacity that would emerge under the program proposed here. The fact of old age is something which involves a minimum of deception, "chiseling," and administrative investigation. It is therefore the one social welfare undertaking that is reasonably well adapted to federal management. Federal operation of health and disability benefit systems presents far greater difficulties of management because of the immensely greater uncertainties of objective diagnosis. If it should be established that there is need of public action in the fields of health and disability, after taking account of the economic advantages accruing to all citizens and to all sections from the program offered here, the proper agency to deal with these matters would appear to be the states, rather than the federal government. It can safely be asserted that no public action in the fields of health and disability can be competently administered without active and extensive participation of local administrators, persons who are in position to learn the facts and detect the frauds in individual cases. State responsibility for such services, if they prove necessary, is the only way to develop strong local cooperation and efficient administration.

Whatever the scope of the federal OASI system, there are two aspects of the subject which must be emphasized here as germane to the main problem. These involve the disposition to look upon the payroll taxes and the benefit payments as a means of influencing the economy toward inflation or deflation, respectively. During the period of intense postwar inflation, an increase of the OASI payroll taxes was urged as a means of diminishing purchasing power and thus of curbing the inflation.

If it were true that higher payroll taxes are effective as an inflation curb, then it should follow that the rates of these taxes

should be reduced under deflation conditions. This course is not recommended by those who follow this line. Their reliance would be placed, in a depression, on the supposed stimulating effect of the benefit payments.

This reasoning is peculiarly inappropriate in the case of the OASI system. The benefits paid out are determined mainly by the number of workers aged 65 and over and their dependents. There will be some shift of those eligible for benefits from employment to a benefit status with a decline of business activity but the total increase of the benefit outgo for this reason cannot be large enough and prompt enough to exert material influence upon the total spending in the economy.

The fact of the matter is that payroll taxing and benefit spending operate just like all other taxing and spending. That is, they are essentially a transfer process which does not affect the overall total of spending power. The current collection of taxes greatly in excess of current benefit payments appears, superficially, to be a deflationary influence, but whether it is actually so or not depends on the use made of the excess of receipts. Prior to the emergency of a budget surplus these funds were "borrowed" from the trust account and used for general purposes. To that extent, borrowing from the public was lessened, but whether the final effect was to avert by so much the inflation of credit would depend on the alternative kind of borrowing that was thus diminished. Only if the net effect were a smaller amount of bank loans could it be said that the use of trust account funds held down the inflation potential.

The interest-bearing debt declined by \$27.2 billion from February, 1946, to June, 1949, the principal source of funds being the general fund cash balance. But the marketable debt was reduced by \$44.7 billion in the same time. The difference between the reduction of marketable debt and of overall debt, some \$17.5 billion, is accounted for by a rise of \$5.6 billion in non-marketable debt, principally savings bonds, and of \$11.8 billion in trust account debt holdings. This *de facto* transfer of debt from the public to non-marketable and trust account issues would appear to have been deflationary, because more than three-fourths of the total decline of marketable debt occurred in the holdings of the Federal Reserve

and commercial banks. On the other hand, all commercial banks increased their loans and investments by \$16.7 billion from December 31, 1945 to June 30, 1949, thereby virtually offsetting the decrease of marketable debt produced by the shift to non-marketable debt and trust accounts. In other words, any deflationary effect of the sterilization of marketable debt by the shift into savings bonds and trust account special issues was compensated for by an almost equal expansion of private credit, which is, of course, fully as inflationary as public bank loans.

The conclusion of the matter is that while the government operations may have certain effects upon the credit structure, it is unsound, and it may be dangerous, to manipulate the rates, the benefits, and other features of a system which has, as its primary objective, certain kinds of protection for the aged and their dependents, in order to produce in the economy as a whole inflationary or deflationary results deemed to be desirable by the planning agencies. No better indication is needed of the large factor of error in the judgments on which these agencies have formulated policies than the mistakes that have been made in the last three or four years with respect to forecasts of employment, the course of prices and inflation, and the effect of public spending. Government does not, and cannot, support the economy. It should stop trying to do so. The program offered here is designed to free the productive forces, in the greatest degree possible, from the dead weight of the governmental costs incurred under the doctrine that government can support the economy; and to afford protection to all taxpayers against excessive, arbitrary taxation. It is designed, also, to bring a larger share of the necessary public service responsibilities closer to the people, and thus to afford them a better basis of judging between the benefits and the costs of these services. It is the only means of arresting and reversing the trend toward national collectivism.

The second aspect of the social benefit system that is of importance in the present connection is that of the degree to which the support of these benefits may come to be carried by general revenues. Currently these benefits are financed on a contributory basis. This principle is sound and should not be abandoned. Any level of benefits which involves a substantial inroad on general

revenues would force the federal government to resume again its invasion of the taxable capacity which should be the domain of the states, and thus it could lead to a collapse of the balance between federal and state tax resources which is the necessary price of state freedom from federal domination.

State Trust Fund Receipts.

In the schematic allocation of tax sources given above it was proposed that the states should accumulate and handle the payroll taxes which they now collect for unemployment compensation benefits. This recommendation is intended to mean that the entire responsibility for this service be relegated to them. Such is, indeed, the present situation except for the formality of transferring the amounts collected over to the federal government as custodian and the allotment to the states in reimbursement of administrative costs of a portion of that part of the payroll tax which is retained by the former (this rate is .3 percent of payrolls). Whether the so-called reserve now held in trust should be distributed or be left where it is until drawn out for payment of benefits is not a matter of first importance. A proposal for retention of the formality of a federal tax to fortify certain federal policing, but with complete offset against the state tax as long as the federal regulations are met, is mentioned in Chapter 9.

The railroad unemployment compensation system is left for the present in federal control, but it is proper to consider a full integration of it with the state systems.

CONCLUSION

The advantages of this program are evident. It deals with the problem of governmental reorganization from the standpoints of both spending and taxing, and at the state as well as the federal level. It therefore assures a substantial overall reduction of the burden of government. It points to the only way by which the American constitutional system of a union of sovereign states can be preserved. It affords definite assurance that the best possible governmental environment for the free private enterprise system will be created and maintained. And it offers the prospect that the scope of the

federal administrative organization can be reduced to dimensions that will permit the introduction of reorganization measures through which the functions properly belonging in the federal domain can be performed with much greater efficiency. All of these benefits add up to the supreme advantage of continued national economic growth, a shift of governmental services closer to the people who must pay for them, and a firm foundation for individual freedom in rejuvenated state sovereignty.

Accomplishment of the objectives laid out in this program will require drastic political surgery. But all thoughtful citizens will realize that the awful blight of the total state will no longer be a threat to the full development of our great national potential of resources, manpower, and capital. The highway of national economic and social progress will be clear of its most serious roadblock.

CHAPTER 2

EFFECTS OF THE PROPOSED CHANGES IN INDIVIDUAL AND CORPORATION INCOME TAXES

The most extensive and important changes proposed in this program with respect to taxation relate to the federal individual income tax. No substantive changes are recommended in the federal corporation income tax, but some reduction in the revenue from this tax, by comparison with the 1949 yield, is contemplated. The rates required to produce the revenue recommended to be obtained from the income taxes will be determined by general business and economic conditions. According to Table I, the relation of the recommended income tax receipts to the 1949 receipts would be as follows:

TABLE V
INCOME TAX RECEIPTS, ACTUAL 1949, 195X, AND
REDUCTIONS UNDER THE PLAN
(Millions)

Tax	Actual 1949	Proposed 195X	Reduction from 1949
Individual income tax, less refunds ^a	\$16,352	\$ 9,000	\$7,352
Corporation income tax, less refunds	11,140	9,000	2,140
Totals	\$27,492	\$18,000	\$9,492

a. The method of estimating individual income tax refunds properly chargeable against actual tax collections in the fiscal year 1949 is described in a footnote to Table I.

The changes recommended in the individual income tax constitute such a radical departure from the present trend of tax policy and tax thinking as to require a fairly complete explanation. It is necessary, also, to supply data relative to the tax rates that would produce the revenue projected for both individual and corporate income taxes, and to indicate how the federal income

taxes would affect both the individual taxpayers and the economy as a whole. These matters are dealt with in the present chapter.

THE INDIVIDUAL INCOME TAX

Advantages of the Flat Rate.

The key factor in the entire re-allocation program is the change that is proposed in the federal tax on individual incomes. This change is that the federal tax be levied at a flat or proportional rate. A corollary of this proposition is that the states, in their discretion, may tax individual incomes at such rates as they may severally determine.

The reasons for a proposal, which to many will appear revolutionary, are as follows:

First, it is essential that the states have access to an adequate area of taxable capacity to enable them to finance the service responsibilities to be assumed by them. This requirement has been recognized by virtually every group that has studied the federal-state fiscal problem. The Hoover Commission has recently stated it in the following words:¹

We recommend that our tax systems — National, State, and local — be generally revised and that, in this revision, every possible effort be made to leave to the localities and the States adequate resources from which to raise revenue to meet the duties and responsibilities of local and State governments.

It is significant, however, that this recommendation, like so many earlier pronouncements by other groups, is in general terms and offers no specific clue to the solution. But it is clear that the solution lies in the reduction of the federal tax burden on individual incomes. This is true because all taxes are paid out of current income, and the only way by which the states can draw larger tax revenues from current income is to increase the "take-home" income of the citizens by reducing the federal tax drain upon it. It cannot be too strongly emphasized that this does not mean an obligation on any state to introduce an individual income tax, unless local sentiment favors such action. When the pool of individual income is enlarged by lowering the federal tax, it can be drawn upon by the several states in various ways. The funda-

¹ *Hoover Commission Report on Federal-State Relations*, p. 35.

mental thing is to increase citizen taxable capacity by giving relief from the federal tax. Each state may then devise its own methods for taxing, but the income pool must be large enough to be drawn upon to the extent required without resulting in excessive or unduly burdensome tax levies of any sort at the state level.

Second, no other adjustments of the federal tax system would make available to all states a sufficient volume of tax resources. In some quarters repeal of all federal excises except the liquor and tobacco taxes has been suggested, the ensuing federal revenue loss to be made up by higher rates on individual or corporate incomes. This plan would not meet the requirements of a comprehensive tax re-allocation program, first, because the higher federal income taxes would strike at the roots of citizen capacity to support, by any kind of tax, the services of state and local government; and second, because the various repealed excises would not be, in all cases, suitable sources of state revenue. Some states might get by, but many could not.

Third, the restriction of the federal tax on individual incomes to a flat rate would establish the condition most favorable, from the tax standpoint, for the saving and investment so essential to the maintenance of an adequate volume of capital formation. This subject is germane to the overall fiscal program under consideration here because it has already been shown that the principal reason for marked variations in wealth and income in different sections of the country is lack of capital in backward areas. A survey of the South's economic position recently issued at Duke University carried an estimate that this region needed and could profitably use as much as \$5 billion in capital investment. A moderate flat rate of federal tax on individual incomes would remove the barriers which are now imposed by the high tax rates to risk investment in the relatively undeveloped areas. With the economic growth that much greater capital investment would stimulate in these presently economically backward sections, the case for large federal grants to them would disappear, and with it would go part of the case for holding the federal tax receipts at so high a level.

Fourth, a uniform, proportional tax rate on all individual incomes is the only way by which excessive income taxation can be avoided. It was pointed out in Chapter 1 that there is no

effective restraint against excessive, or even confiscatory, taxation of incomes by the federal government. The use of steeply progressive or graduated rates presents a constant temptation to narrow the income tax base by increased exemptions and to offset this loss by higher rates toward the top of the income scale. In addition to the outright destructive effects of such a policy upon the vigor of the productive forces, this policy provides support for the illusion that governmental services are being paid for by some one else. The leveling that is produced by this kind of taxation is always downward, never upward.

Fifth, a flat rate income tax is a realistic application of "ability to pay." This concept is not well understood, and in consequence it has often been misused and misapplied. The most generally accepted connotation relates to income, and in this case it means simply that the ability to spend for anything increases as income increases. If A has twice as much income as B, A can spend twice as many dollars as B can. But A clearly cannot spend four times as many dollars as B can, with only twice as many dollars of income. This strictly proportional relationship between income and ability is always clearly perceived and understood when consumers come into the market place. There, nobody would fail to see that in the long run A could buy twice as much as B, having twice the income, and that A could not possibly buy, year in and year out, four times as much as B. And it should be just as apparent in taxation as it is in the market that ability to pay has a direct proportional relationship to income. Hence, a proportional or flat rate of tax on income is a manifestation or application of the ability to pay doctrine.

The present federal income tax rate schedule is designed, however, on a different principle. The following comparison of taxable incomes and of taxes due thereon will illustrate that difference :

Taxable Income	Income Tax
\$ 4,000	\$ 840
16,000	5,200
32,000	14,460

Here it is seen that a fourfold increase of taxable income, from \$4,000 to \$16,000, results in more than a sixfold increase of tax, from \$840 to \$5,200. An eightfold increase of taxable income, from \$4,000 to \$32,000, results in more than a seventeenfold increase of

tax. If the comparison be extended farther up the line of income, the following illustrative results appear :

\$ 20,000	\$ 7,260
60,000	34,320
50,000	26,820
100,000	67,320

The program offered here does not entirely eliminate the element of tax rate progression. Even a flat rate on all taxable income results in a graduation of the tax in relation to total income if each taxpayer is allowed deduction for personal and dependency credits. It is recommended that such deductions be continued at the amounts authorized by the 1948 Revenue Act, namely, \$600 for the taxpayer and for each dependent. This is illustrated, for the case of a married person with two dependents, in Table VI.

TABLE VI

TAXABLE INCOME, INCOME TAX LIABILITY AT A FLAT RATE OF 11 PERCENT, AND EFFECTIVE RATE OF TAX ON TOTAL INCOME.

Married Person with Two Dependents^a

Gross Income	Taxable Income	Tax	Effective Rate
\$2,500	0	0	0
3,000	\$300	\$33	1.1
5,000	2,100	231	4.6
10,000	6,600	726	7.3
25,000	21,600	2,376	9.5
100,000	96,600	10,626	10.6

a. Personal and dependency credits assumed to be \$600. In lieu of specific deductions, a standard deduction of 10 percent of gross income, with a maximum of \$1,000, is assumed throughout.

Here is a range of graduation from 1.1 percent at \$3,000 of income to 10.6 percent at \$100,000. Thus the tax burden is actually increased at a progressive rate as income increases. The graduation is measured against total income, but there is nothing in the doctrinal theory of progression to show that this is not as good a base as the arbitrarily determined statutory concept of taxable income. Nor is there anything in theoretical doctrine to establish that such a degree of progression as is shown here is not sufficient.

Sixth, a flat rate income tax will be less difficult, and far less

costly to administer, than the present one. When the issue of fiscal soundness is viewed positively, it can be said that an important test of a good tax, in this case a sound tax, is the degree to which it can be administered without involving extensive litigation, continual legislation to plug loopholes, and the development of bad relationships between the government and the taxpayers.

On these counts a proportional tax at a moderate rate would be far superior to the existing progressive system. At present, the major objective of administration must be, under the law, to make certain that all incomes, large or small, received by or accruing to individuals are fully taxed. But this leads to such provisions as are found in Section 102, in the treatment of capital gains, in the double taxation of dividends, in many of the elaborate provisions relating to corporate reorganizations, in those relating to trusts, and various others. In large measure these sore spots would vanish, or would no longer involve vital issues, under a moderate flat rate tax. The income tax chapter of the Internal Revenue Code would be short and simple, for it would need no longer to contain much elaborate verbiage that now appears necessary to pin the taxpayers down while the screws are being applied.

And more important than any of these gains, the problem of evasion would be largely solved, for it is a well-established fact that the existing rate scale is a powerful temptation to resort to illegal practices. Government is never more unjustly harsh and autocratic than when it creates strong incentives to evade a law and then imposes severe penalties upon those who succumb to the temptation. And both the attitude and the results of such autocracy are nowhere more evident than in the operation of the income tax.

Arguments Regarding the Flat-Rate.

Several lines of argument are to be anticipated against a federal income tax at a flat rate. First, it will be said that such a tax is unsound from the standpoint of general economic and taxation doctrine, second, that such a tax is unsound as a fiscal measure, and third, that it will in effect be a transfer of tax burdens from the rich to the poor. These points will be discussed in order.

First, the tax is unsound from the standpoint of taxation doctrine.

Merely academic discussion of the pros and cons of progressive taxation is beside the present issue. The communist origin and sponsorship of this method of taxation are now well known, although they have been too long ignored. Notwithstanding this discreditable ancestry, it will not be easily uprooted.

It is sometimes pointed out that most professional economists approve progressive taxation. The foundations of such approval as exists were laid in the college courses of a generation ago when the doctrine was still in the blueprint stage and its potentialities for abuse had not as yet been exposed. Many professional economists are completely unaware, apparently, of the inconsistency involved in upholding, simultaneously, free enterprise and private capitalism, and also a major tenet of communism.

The 16th Amendment does not specify or require any particular kind of tax rate policy. The Supreme Court has never ruled that progression is essential to the purposes of this amendment. Neither has it ever intervened to protect federal taxpayers, regardless of how closely the rates imposed may have approached to complete confiscation of income.

The taxation of individual incomes by the states has always been a matter regarding which each state has had complete freedom, subject only to the restrictions of its own constitution. This program anticipates no change in that situation, and it is to be expected that local sentiment and judgment will determine, in the future as in the past, the character of the several state tax systems.

The extent to which the states are now taxing individual incomes was indicated in Chapter 1. Thirty out of thirty-six jurisdictions which tax individual incomes are imposing progressive rates. This indicates that progression in income tax rates is now applied by the states on a scale sufficiently extensive to emphasize the need for elimination of this principle at the federal level.

The levy of income tax by the states, at whatever rates they may determine, does not repudiate the "ability to pay" principle. Each person would still be taxable on his entire income for federal purposes; and if his residence were in a state that imposed income tax, he would also be taxed there for state purposes. The most

generally applied procedure in state income taxation is to tax all residents on their entire income, with reciprocal arrangements for exemption in the case of non-residents deriving income from sources within another state. State income tax administration is, or can be made, equal to or even superior to federal administration. Everywhere, it could be free of the enforcement devices which have been so discreditable to federal administration.

It was shown above that any allowance to taxpayers by way of exemptions will always have the effect of introducing an element of graduation, even under a flat rate tax. Moreover, the 16th Amendment does not define income, and there is nothing in the academic theorizing to demonstrate that total income is not as sound a basis for comparing and measuring tax burdens in relation to income as the arbitrary legal concept of "taxable net income." It would appear that the effective progression produced by a flat rate with the present exemptions, which rises from 1.1 percent on \$3,000 to 10.6 percent on \$100,000 is in itself a sufficient application of the progression policy to satisfy all reasonable ideological requirements. To demand more than this in the federal tax would intensify the suspicion that nonfiscal motives were paramount.

The taxation of individual income by the states, to the extent, and at such rates, as they may severally determine, would provide an automatic restraint against abuse, a protection that will always be lacking at the federal level. As already pointed out, such restraint will be created by the competition among the several states to attract or to hold residents. The long run pressures thus developed will keep state income tax rates at the levels essential for revenue purposes, and will prevent resort, in any state, to punitive, equalizing, or other nonfiscal tax purposes.

Second, another line of argument to be anticipated against the flat rate federal tax on individual incomes is that it is unsound as a fiscal or revenue measure. This can be taken to mean various things such as: a) it will not produce enough federal revenue; or b) it would involve undue — or improper — dependence on other revenue sources; or c) it disregards the principle of "ability."

The last-mentioned criticism has already been examined, and it has been shown that a flat rate tax on incomes is in accord with the ability principle.

With respect to the contention that the flat rate will not produce enough revenue, it can be said that as the functional re-allocations and other economies provided for in this program are introduced, the federal government will have no need for more revenue than will be produced by a moderate flat rate tax on individual incomes, together with the other revenues proposed for federal use.

The progression of the federal income tax has been chiefly responsible for the Great Illusion that federal money is "free" money. The high rates on the incomes of a small number of taxpayers are popularly assumed to produce the bulk of the revenue, hence it is generally believed by the great majority that some one else is providing the money that is spent for their benefit.

Actually, with a first bracket rate at or near the present level, this rate produces 75 percent or more of the total individual income tax receipts, regardless of the degree of progression. It does not follow that the federal revenues would be jeopardized by limiting the income tax to a flat rate. In fact, there would be relatively greater stability of yield from the flat rate than from a system of steeply progressive rates.

The reason is that the higher rates are on income brackets in which the principal income components are dividends, individual business profits, capital gains, and other forms of income that are very sensitive to changing economic conditions. Any attempt to increase the degree of dependence on the surtax (e.g., by raising exemptions and steepening the progression) would lead to still greater instability of federal receipts from this source.

The answer to the charge that a flat rate of individual income tax would involve undue or improper dependence on other revenue sources is that there is today far too great dependence on income taxes for the long-range stability of the federal finances. The individual income tax now provides virtually half of all federal tax receipts, and both income taxes together make up about three-quarters of the total.

The record of tax yields from different taxes under varying business conditions reveals greater instability in income tax receipts than in the case of any other tax. Less emphasis upon income tax and more on other taxes will assure greater stability in budget

receipts and will promote budgetary equilibrium under all circumstances.

The case against as great a degree of reliance on the income taxes as now exists has been demonstrated by recent federal experience. It is characteristic of the instability which these taxes have always displayed that the receipts from them soar in boom periods and dry up rapidly in periods of recession or business decline. The immense receipts of the boom period tempt the Congress and the Administration to embark upon large expenditure programs and to incur immense open-end future commitments. Then, when the income tax receipts fade out with a decline of national income, it is said that the budget simply cannot be balanced under such conditions and a resort to deficits becomes not only inevitable, but it is accepted as a sensible procedure. In view of the immense size of the national debt, and the dangers for the whole economy in allowing it to increase in peace time periods of high level production and employment, the toleration of further debt increase is indefensible.

Yet, precisely this situation now exists, and there is a very general attitude that nothing can be done about it. The source of this fiscal policy, and of the current defeatism, is the extreme dependence upon income taxes, that has come to pass. The artificially inflated revenues resulting from the behavior of the income taxes in a boom have betrayed us into a spending course that does make retrenchment a very difficult matter. But had there been in operation a better balanced federal revenue system, it is safe to say that a more sober and moderate budget program would have been laid out, with a far brighter prospect of supporting it year after year without the necessity of deficits.

Third, it will be argued that the flat rate individual income tax means a shift of tax burdens from the rich to the poor. Since this involves a key factor in the re-allocation program, any implication that the program, or an essential element of it, would involve a rank or unjustified discrimination in the distribution of the tax burden, deserves full and careful attention.

The fundamental point to be considered is that the program deals with a new distribution of both federal and state-local tax burdens. All levels of government in the United States must be supported from the same general source, which is the income of the

citizens. No adequate final judgment can be rendered about the program which does not take this basic fact into account. And any quick decision regarding the results of the proposed changes in the federal tax system, regardless of the counter-balancing changes to be made at the state level, would be superficial and inaccurate.

The substitution of a flat rate of individual income tax for the existing graduated or progressive federal tax would obviously mean a greater reduction, both in dollar amounts and in percentages, for large incomes than for small incomes. The large incomes are now paying the heaviest taxes, at the highest rates, and from this standpoint alone, they would get relatively the most relief. This is a matter of plain and simple arithmetic.

But it does not follow that the result of this adjustment would be a shifting, or transfer, of an additional tax burden from the large to the small incomes. The re-allocation program contemplates a broad and comprehensive realignment of functions and tax resources which will result in a substantial tax reduction for everybody. The statistical projections of this program indicate that a flat rate of 11 percent or thereabouts would provide as much revenue from the individual income tax as the federal government would need to obtain from this source. The illustrative examples of income tax reduction given below show the extent of the tax saving to be afforded to even the smallest taxable incomes. When tax reduction is universal and substantial, as it would be under this program, there can be no valid question of shifting tax burdens from one group to another. It is therefore inexact and misleading to allege that the flat rate individual income tax, at the level of rates proposed and realizable under the re-allocation program, involves a shifting of tax burdens. It actually involves a relief from federal tax burdens for all.

The real sticking point in getting approval of a flat rate income tax is in the view that it would be a policy of "unsoaking the rich." But it has been shown above that there is to be an "unsoaking" of all taxpayers, and not merely of the rich.

This view implies, however, that the "rich" should continue to be "soaked." When the idea is followed through to find out why, and also to find out how much, the rich should be "soaked," a variety

of reasons are encountered. Prominent among them are the following:

1. The frankly expressed Marxian doctrine regarding the destruction of private property ownership and the efficacy of heavy progressive taxation as an instrument to achieve this end. Only a small number openly admit adherence to this strict party line.

2. The "rich" have greater ability to pay. The meaning of the term "ability to pay" has been discussed above, and it is shown there that ability increases with income. It is evident, of course, that even at a flat rate of tax, the amount of tax will also increase as income increases. It has been shown, further, that the effective rate of tax displays a progressive pattern in relation to total income when deductions and exemptions are allowed to all taxpayers. This is a result of plain, ordinary arithmetic, with no social connotations other than such as may inhere in the customary provision for these deductions and exemptions. Finally, it has been pointed out that some thirty state and territorial jurisdictions are now taxing individual incomes at progressive rates, and hence that a considerable proportion of individual income would thereby be taxed at such rates, in addition to the flat rate which all would pay for federal purposes.

If the rich are to be "soaked" by being subjected to progressive tax rates on income, there is a strong element of both poetic and practical justice in doing it at home, where these persons live, for the direct support of state and local services, rather than doing it by remote control through a federal tax. The heavy federal tax at steeply progressive rates has contributed to the great illusion that federal money is free money. The bait of this illusion, plus the fact that the federal taxes deplete state revenue resources, has persuaded, or forced, the states to accept federal grants and the growing domination which the grant system inevitably entails.

3. Many non-communists sincerely believe that there should be some degree of income tax rate progression in order to comply with an ability concept which some vague "hankering" for social justice has induced them to accept. There is no one in this group, however, who can offer a rational or scientific support for the particular progressive rate scale that would properly fit and express the ideal. The best, and the most, that any of these idealistic ad-

herents to the progressive doctrine can offer is that there should be "some, but not too much" progression.

Assuming that this were, indeed, a counsel of perfection, it is unrealistic and impractical, for it leaves the door open for determination of the actual tax rates by political expediency, class prejudice, or sheer guesswork. Thus, there has happened, and there can happen again, tax excesses against which the small minority most seriously affected have no protection.

4. Some are likewise sincerely troubled about the possibility that certain large incomes may spring from monopoly or other socially undesirable sources. These persons accept tax rate progression as a remedy for such a condition.

It must be recognized, almost as a truism, that inequality of incomes is both inevitable, and desirable, in a free society. The other alternative, namely, a uniform level of individual incomes regardless of differences in talent or productive capacity, would be deadly and would shortly result in there being nothing but poverty to share. England is moving rapidly toward this condition.

The tax law is not a proper instrument, either for the correction of such degree of income inequality as may be incompatible with the best interests of productive efficiency, or for weeding out the wrong kinds of big incomes. By and large, in a competitive economy, incomes will tend to be determined and limited by the relative productive contributions of the recipients, and the maintenance of free channels of competition is the best way of assuring that income does tend to correspond with productive effort. The socially adverse big incomes from monopoly, racketeering, vice rings, etc., can be adequately dealt with only through police measures aimed directly at the practices from which such incomes spring. The only test that the tax law can apply is size, and this test alone affords no clue to the moral or social aspects of income bigness. And since the tax is not collected until the income exists, severe taxation would come too late to protect the people against the abuses that give rise to socially bad large incomes, even if these could be singled out for separate treatment.

This is an appropriate point to refer to the view held by some ardent supporters of tax progression that as long as the income recipient has enough left, after taxes, for maintenance of a reason-

able living standard, it is proper for government to take all the rest of his income. England provides a good example of the operation of such a policy, for Sir Stafford Cripps and others have recently said that only a bare handful of Englishmen now have an income exceeding \$17,000 (at the 1950 value of the pound) after taxes. The pitiful plight of Socialist England would be much worse, even, than it is were it not for the support given by Capitalist America.

In view of the many times that the error of socialist-communist economic thinking has been exposed, it should hardly be necessary to cover that ground again. But this error lies at the root of the kind of tax doctrine which has been responsible for the excesses of tax rate progression that have occurred, and for the even greater excesses that have been advocated in some places. It is worthwhile, therefore, to state the issue, very briefly, once more.

1) The total national product consists of the aggregate of all goods and services created in the economy. This product must supply the consumption needs of all the people, and also the things required to maintain and extend the nation's stock of capital, or the productive apparatus used in further production.

2) Viewing the national product in terms of expenditure, the distributive shares of the total payments made consist of wages, interest, and profits. (For the present purpose economic rent may be considered as interest on specific investments in land.)

3) The socialist-communist doctrine is that wages would be higher if there were no interest or profits. This notion harks back to the interpretation of Marx and Engels that interest and profits are "exploitation" incomes for which no parallel service or contribution to product is made by the recipients thereof.

4) The way to abolish interest and profit as shares of the product is for the state to own the productive capital equipment. Russia has reached this stage and England is moving toward it by her nationalization measures. The United States is following England's example.

5) It is just as true in a communist economy as in a free

enterprise economy that a portion of the product must be diverted, or plowed back, into capital if production is to continue. Under no circumstances can the workers be given all of the current product, even if private interest and profits were abolished.

6) The issue thus boils down to this — can government perform the functions of capitalist and entrepreneur more efficiently than they can be performed by those free, private citizens who are willing, under proper conditions, to assume them? Government operates by coercion, while private citizens respond to economic incentives, which in the present case consist of adequate material rewards in the form of interest and profit.

7) The outcome is readily determined by purely pragmatic tests, in which there is no place for social or other non-economic doctrines. Under which system will the workers get for their own use the larger share of the total product?

To the present time there is only one answer. The total product is much larger, and the workers' share of that product is much greater, under a free, private enterprise system than under any alternative system. These results, however, can only be assured and sustained by permitting the free, private enterprise system to function according to the laws of its own nature. Even this system cannot continue to deliver if it is to be handicapped by having imposed upon it restrictions and burdens, the source and inspiration of which are the doctrines and ideology of a diametrically different economic system.

It is therefore sheer economic folly to tolerate a method of taxation which has the result of skimming off a large part of the income that is needed for maintenance and enlargement of the nation's capital, and that would be devoted to these purposes were it not for a tax that renders this impossible. The jobs and income of the workers are jeopardized when the return flow of income into capital is cut off or markedly diminished. Here is a most serious and costly shift of burden to the workers and the low income groups generally. Instead of the elimination of tax rate progression from the federal scene being a transfer of burden from the rich to

the poor, it is a step whereby the incomes and the living standards of the "poor" will be raised.

Operation and Effect of the Flat Rate.

According to 1949 data, the net tax liability of individuals under the income tax at the rates of the 1948 Act was \$16.3 billion. Hence, viewing the program as it concerns this tax, there would be a reduction of some \$7.3 billion below the 1949 tax liability. It remains now to undertake an approximation of the prospective level of taxable income in order to indicate the rate that would be required to produce \$9 billion of revenue.

The Probable Level of Taxable Income. The flat rate of income tax that would be required to produce \$9 billion, or any other amount, of tax would be dependent upon the amount of taxable income. In the absence of estimates or compiled statistical data, it is necessary to undertake a derivation of this figure in roundabout ways.

The latest published statistics of income based on individual returns relate to the calendar year 1946. At that time, the personal credit or exemption for the taxpayer and each dependent was \$500. Taxes were determined by the high rates of the 1945 Act but were reduced by a 5 percent tax credit. Personal income as estimated by the Department of Commerce averaged \$174.4 billion for the calendar years 1945 and 1946. The indicative data in Table VII have been developed from the 1946 returns:

TABLE VII

DERIVATION OF TAXABLE INCOME AND TAX LIABILITY,
1946^a, BY ADJUSTED GROSS INCOME CLASSES BELOW
AND ABOVE \$5,000

(Millions)

Category	Adjusted Gross Income Classes		Total
	\$0-\$5,000	\$5,000 and over	
Adjusted Gross Income	\$81,945	\$36,105	\$118,050
Deductions	9,646	3,496	13,142
Net Income	72,299	32,609	104,908
Exemptions	35,214	4,453	39,667
Taxable Income	37,085	28,156	65,031
Tax Liability	7,141	8,935	16,076

a. The preliminary data on statistics of income for 1946 do not supply all of the above figures, and the method of derivation should be explained. Income returns were made in

1946 either by taking a standard deduction of 10 per cent or \$500, whichever was lower, or by itemizing the deductions. With respect to adjusted gross incomes reported on standard deduction forms, the deductions were computed by taking 10 per cent of total gross income in the income classes up to \$5,000, and by allowing \$500 for each return in the income classes above \$5,000. The net income figures in Table VII are therefore derived by the computation here described.

From these data it appears that with personal income at a level of \$174.4 billion, the net income reported in taxable returns was \$105 billion in round figures. This total was reported in 37,916,000 returns.

The next stage in the derivation process is provided by data in the report of the Senate Finance Committee on HR 4790, which eventually became the 1948 tax reduction law. These data were compiled for the Senate Committee on the assumption that personal income in 1948 would be \$208 billion. As later estimated by the Department of Commerce, personal income in 1948 was \$211.9 billion.

From the Senate Finance Committee report, and supplemental information supplied by the staff of the Joint Committee on Internal Revenue Taxation, the following table has been constructed:

TABLE VIII
ESTIMATES OF NET INCOME, TAXABLE INCOME, AND TAX
LIABILITY, 1948^a
(Millions)

Category	Net Income Classes		Total
	\$0-\$5,000	\$5,000 and over	
Net income	\$104,555	\$34,036	\$138,591
Exemptions	54,368	6,926	61,295
Taxable Income	50,187	27,110	77,297
Tax liability	8,664	8,220	16,884

- a. A brief explanation of method is required here, since the Senate Committee report contains no data on the amount of exemptions. This item was arrived at as follows: In the 1946 returns a total of \$39,667 million of exemptions was claimed in 37,916,000 returns. The average exemption per return was, therefore, \$1,046. The Revenue Act of 1948 raised the exemption from \$500 to \$600, an increase of 20 per cent. It also provided an additional exemption of \$600 for persons aged 65 and over, and for the blind. For the present purpose it is assumed that these additions would raise the average exemption per return to \$1,300. The Senate Finance Committee estimated that there would be 47,150,000 returns in 1948, hence the total of exemptions claimed would be \$61,295 million. It has been assumed that this total would be distributed in the net income classes below and above \$5,000 in the same proportion as that which existed in the 1946 returns.

Several points should be noted. First, the estimates place the bulk of the increase in net income from 1946 to 1948 in the net income classes under \$5,000. It should be borne in mind that the net income classes of the 1948 tabulation are not comparable with the adjusted gross income classes of the 1946 tabulation. In 1946 there were 14,900,000 nontaxable returns made, in which adjusted gross income of \$16 billion was reported. The initial effect of the expansion of personal income by some \$37.5 billion from 1946 to 1948 would naturally be to lift a large proportion of this group from a nontax to a tax status. The Senate Committee's estimate of taxpayers in 1948 is roughly 10 million over the number of taxable returns in 1946. And as these persons move into the taxable classification, most of them would come in at the lowest taxable income levels.

Second, there is almost the same absolute spread between estimated total personal income and estimated net income respectively, from 1946 to 1948. Personal income, by Department of Commerce estimates, increased \$35.0 billion, and net income, as defined by the tax law, advanced in the same period by \$32.2 billion. In view of the numerous differences between the definitions of income in the national income series and in the tax law, this difference of some \$2.8 billion is not irreconcilable.

Third, the growth of taxable income, which was \$12.3 billion from 1946 to 1948, may be regarded as indicative of the rate at which the income tax base expands as national income rises, although the interim changes of the exemptions in this particular period enter as a disturbing factor. For each increase of \$2½-\$3 billion in personal income, an additional \$1 billion is found in the individual income tax base.

Fourth, the readjustment of rates, exemptions, and credits in the 1948 law had the result of holding the net tax liability close to the 1946 level, notwithstanding a substantial increase of personal income and net income. The individual income tax collections in the fiscal year 1949 were \$18,052 million. Our estimate of refunds properly chargeable against this total is \$1.7 billion, leaving an estimated net tax liability of \$16,352 million, which compares with \$16,076 million in 1946.

For the present purpose the important outcome of the pre-

ceding calculations is the light to be shed upon the probable level of taxable individual income under present conditions. According to Table VIII, this income would be \$77.3 billion if personal income were to be \$208 billion and the provisions relative to deductions and exemptions were unchanged from those of present law. In 1948, personal income was almost \$212 billion, which should mean the addition of more than another billion dollars to the taxable income base, bringing it close to \$79 billion.

A different approach to the problem yields a corroborative, though slightly lower, result. This approach is as follows: In the 1946 returns, some 76.9 per cent of the total tax liability was the product of the basic effective rate of 19 percent, and 23.1 percent was produced by the surtax rates.² Table IX indicates how the relationship was established.

TABLE IX

CALCULATION OF BASIC AND SURTAX YIELDS, 1946

Taxable income in 1946	\$65,031 million
Total tax liability in 1946	16,076 "
Effective basic or first bracket rate, 19 per cent	
Tax produced by 19 per cent (\$65,031 x 19 per cent)	12,356 (76.9%)
Yield of surtax rates (\$16,076-\$12,356)	3,720 (23.1%)

The arithmetic of the foregoing calculation is that the lower the effective surtax rates are in relation to the basic rate, the smaller will be the yield of the former. It is not possible to determine now the precise effect of the relative changes made by the 1948 act in both the basic and the surtax rates and the credits

² The nature of the income tax rate structure and the grounds for stating the proportions of the total tax produced by its different parts should be explained. The rate scale from bottom to top is separable into two parts, as the following illustration shows:

Income Bracket	Basic Rate	Surtax Rate	Total Rate
\$0-\$2,000	20%	—	20%
\$2,000-\$4,000	20	2%	22
\$4,000-\$6,000	20	6	26
\$6,000-\$8,000	20	10	30
\$8,000-\$10,000	20	14	34

And so on to the top bracket, which includes all taxable income above \$200,000, subject to a basic rate of 20% and a surtax rate of 71%, or a total rate of 91%. From this it is clear that every dollar of taxable income, across the board, is taxed at the basic rate of 20%, while certain slices of income are also taxed at the additional, surtax rates. In the calculation given in the accompanying text this basic rate, reduced to 19% effective rate by the 5% tax credit, was applied to the total of taxable income. The difference between the amount produced by this portion of the rate and the total tax liability is obviously the yield obtained from the surtax rates applied to the successive slices of income in the different brackets.

allowed against the tax. The division of income between husband and wife in tax returns also results in subjecting such divided incomes to lower maximum surtax rates. In view of the actual 1946 experience, it does not appear unreasonable that the basic effective rate of 16.6 percent accounted for as much as 80 percent of the total 1949 tax, as compared with the 76.9 percent of the 1946 tax that was produced by the effective basic rate of that year. On this assumption the yield of the 1949 basic rate of 16.6 percent was \$13,082 million, and the taxable income base was \$78.8 billion.

This program is for concrete application in 195X, which must, of necessity, be a date some years in the future. Unless expansion of the economy is too greatly hindered by excessive governmental burdens and other unwise policies, there should by that time have occurred an increase of national income sufficient to create a taxable income base of at least \$80 billion.

The Required Rate of Income Tax. Assuming, therefore, that at prospective personal income levels and with the 1948 provisions for personal exemptions applicable, there would be a taxable income of some \$80 billions, it would follow that a flat rate of 11.2 percent would be required to produce a yield of approximately \$9 billion from the individual income tax.

The first bracket rate under the 1948 law is 20 percent, against which there is a credit of 17 percent of the tax, making the effective first bracket rate 16.6 percent. Therefore, there would be in prospect, under present income conditions a reduction of the tax rate on the first bracket of taxable income of approximately 5.4 percentage points. On a taxable income of \$5,000, the present tax, after allowable credits, is \$948. At a flat rate of 11.2 percent, the tax would be \$560. The tax reduction for a taxable income of this size would be \$388 or 40 percent of the tax under the 1948 law. This calculation does not take into account the division of income between husband and wife, which affords only slight advantage at the \$5,000 taxable income level. The tax reduction for a taxable income of \$2,000 would be \$108, or 32 percent of the tax payable under existing law. It is apparent, as a matter of simple arithmetic, that neither the dollar amount nor the relative proportion of the tax reduction can be as great in the case of

one who is now paying tax only at the first bracket rate as it would be in the case of persons with incomes which are also subject to the surtax rates. The great number of taxpayers whose incomes are such that they now pay income tax only at the first bracket rate are already being taxed at the minimum rate.

To the question as to what the flat rate would have to be in order to produce a revenue of \$9 billion from the individual income tax in the event that the total of personal income and hence of taxable income, should decline, the only sensible answer that can be given now is that the kind and degree of tax revision and reduction that are offered in this program are the best assurance that can be provided that such a decline will not occur. In fact, it is imperative that there be, as promptly as possible, a substantial reduction of the spending and tax load in order to prevent a decline. Should there be, nevertheless, a drop in the income tax base, an increase of the rate would be indicated unless the necessary adjustment of spending were made.

THE CORPORATION INCOME TAX

The data in Table V indicate that by comparison with 1949 there would be a reduction of the corporate income tax load by about \$2.1 billion, on the basis of current levels of national income. In order to accomplish a major objective of the proposed program, namely the release of adequate tax resources to the states for their own use, it was necessary to set the amount of the corporate tax payment rather than the rate. The prospect of sustained, high level prosperity which this program offers, is the best assurance that can be given that this volume would consistently be high enough to permit some reduction below the present rate. Nevertheless, it must be emphasized again that the kind of sweeping reduction of the individual income tax that is proposed is so essential to the success of the entire re-allocation program that higher rates of corporation tax or of manufacturers' excise tax should be considered rather than any decided expansion of the individual income tax by the federal government.

The presence of a federal corporation income tax at a sub-

stantial rate serves to meet one argument advanced by some who favor individual income tax rate progression at the federal level. This argument is that some geographical equalization, through federal taxing and spending, is proper because of the concentration in certain sections of income derived from business operations covering the whole country.

The argument overlooks the elementary economic fact that nation-wide business operations, like those conducted on a local scale only, involve giving values wherever sales are made. Something, either goods or services, always goes out in exchange for the money received. The manufacture of goods is necessarily concentrated, for it would be highly impractical and wasteful to have a complete array of every kind of factory in every community where there are consumers. The advantages of manufacture, transportation, and distribution at the lowest possible costs are diffused universally. The only part of the consumer's dollar that is eventually gathered at one place is the part that represents profit. Insofar as this profit is plowed back to expand production or reduce costs, consumers share in the benefits wherever they live. And to the extent that profits are distributed as dividends, there is also a considerable degree of diffusion, since corporation stockholders do not all live in one state or section.

Nevertheless, for those who do not accept the foregoing analysis, it can be said that the federal tax on corporation income and the federal spending for purposes of national advantage and concern do constitute a satisfaction of the contention which they advance. There is by this process an indirect return or redistribution to the sections remote from manufacturing centers and company head offices of a part of the profit derived from nation-wide business transactions. Since there is no way of determining precisely how much should be transferred from one section to another according to the doctrine under discussion, it would appear that every reasonable requirement of this sort is met by the federal corporation income tax. Certainly, the doctrine cannot be pushed so far as to become the bulwark for a permanent system of federal grants, or as to demonstrate the necessity of retaining permanently a system of progressive taxation of individual incomes by the federal government.

The Corporation Tax Rate.

At the rate of 38 percent, there would be required taxable corporate profits in the amount of \$23,684 million to provide a revenue of \$9 billion from this source. The data reported by the Council of Economic Advisers indicate, as an average of the years 1945-1949 inclusive, total profits of \$27.4 billion before inventory valuation adjustment, and \$25.2 billion after such adjustment. The income tax law does not, of course, provide for such adjustment in determining taxable income. The case for it, and its amount, alike disappear as the price level becomes stabilized. For 1949, the Council's estimate of the annual rate of corporate profits was \$27.6 billion.³ At this level, a rate of 33 percent would suffice to produce \$9 billion of revenue. Normally no increase above the existing rate should be necessary to provide the amount budgeted for the re-allocation program. It is assumed that a moderation of the rate in the case of companies with net incomes under \$50,000 would be continued on much the present basis.

The effects of any reduction in the corporation tax rate, in the event this becomes possible, must be appraised according to the views held with respect to the burden of the corporation income tax.

According to one view, this tax is regularly shifted to consumers. If this concept be accepted, then a reduction of the tax would lead to a decline of prices and all consumers would share in the benefits. A reduction of prices is equivalent to an increase of income, and the people as consumers could look upon the corporation tax reduction as an addition to such advantage as they would derive, individually, from other features of the program.

According to another view, the corporation tax is a burden on the stockholders, and the tax reduction would, therefore, be reflected in a larger income available for distribution as dividends. If this concept be accepted, the benefit of the reduction would be more restricted than it would be under the other view as to tax incidence, but it would still be widely diffused because of the large number of individuals who own corporate stocks. Estimates of this number vary, but they tend to center around some such figure

³ The Council of Economic Advisers, *Annual Economic Review*, January 1950, Table C-4.

as twelve to thirteen million, which necessarily includes a great many with small incomes.

It is not likely that the opposing viewpoints on tax incidence set forth here will be fully reconciled by any sort of pragmatic demonstration of where the corporate tax burden falls. It is possible that changing circumstances alter the facts of incidence and that no positive statement can be made that would be valid over any extended period. Entirely apart from this issue, however, is the clear and definite fact that a reduction of the corporation income tax would make possible a large volume of funds for capital formation, either through direct reinvestment by the income-earning companies or through the additional savings which individuals could accumulate out of the larger dividends. The second opportunity would be realizable, of course, only if the tax rate on individual incomes were reduced to a level that would permit the saving and provide an incentive therefor.

* * * *

Conclusions:

1. *The individual income tax is the key factor in the problem of intergovernmental fiscal relations, and it is the key factor in its solution: the answer is a flat rate for the federal levy.*
2. The states need access to an adequate area of taxable capacity; a flat-rate federal individual income tax would release to all the states a tax potential more than sufficient to finance their own functions by tax methods of their own choice, without recourse to federal grants-in-aid.
3. Steeply progressive individual income tax rates have an outright destructive effect on the vigor of productive forces.
4. The proposed individual income tax allocation will lighten the tax burden on the economy, create conditions favorable to adequate capital formation by removing the barriers to risk investment, and quicken enterprise.
5. Reduction of federal tax resources will halt the growth of federal burdens and the concentration of federal power.
6. Excessive individual income taxation can be avoided only by a uniform, proportional, federal tax rate.

7. A flat rate of 11.2 percent on individual taxable income of \$80 billion will produce the \$9 billion revenue which is sufficient from this source for federal functions as proposed for 195X. This assumes continuance of present deductions and exemptions.
8. The flat rate tax on individual incomes will reduce or remove present trouble spots in the tax law illustrated by Section 102, double taxation of dividends, and capital gains.
9. The continuance of federal corporation income taxes at a substantial rate maintains a certain geographical equalization of federal taxing and spending.
10. Revenue of \$9 billion would be sufficient yield from the corporation income tax for federal functions as proposed for 195X. At current profit levels, a standard rate of 33 percent will produce the revenue to be required from this source.

Recommendations:

1. The federal government should impose only a flat rate tax on individual incomes.
2. *Restriction in federal use of the individual income tax to a flat rate is so essential to the success of the entire re-allocation program that higher rates of corporation tax or of the manufacturers' uniform excise tax should be considered rather than any continuance of progression in the individual income tax at the federal level.*

CHAPTER 3

EXCISE TAXES AT THE FEDERAL LEVEL

The changes that are proposed in the federal and state systems of excise taxation as part of the overall re-allocation program, are summarized briefly as follows:

1. Repeal all existing federal excises except those on alcoholic beverages and tobacco, and those imposed primarily for regulatory purposes, such as narcotics and fire arms. A corollary of this recommendation is that the states would then adopt, in their discretion, certain of these taxes for state and local use. Coincident with federal repeal, there would be available to the states and localities:
 - a. An increase, where desired, in the rate of gasoline tax, which could be as much as 1½ cents per gallon without any increase of this tax over the combined federal and state rates now being paid. (See Chapter 4.)
 - b. The adaptation to local use of the taxes on admissions, entertainment, dues, coin devices, bowling alleys, and documents subject to stamp taxes. All of these taxes are well within the competence of local jurisdictions to administer. (See Chapter 5.)
2. Introduce, for federal use, a new manufacturers' uniform excise tax, applicable to all end products of manufacture except foods and food products, alcoholic beverages, and tobacco.

Certain features of the recommended excise tax program are discussed here in greater detail.

The Taxation of Alcoholic Beverages and Tobacco.

Alcoholic beverages and tobacco have always been subjected to tax rates above those ordinarily levied on the production or sale of other classes of consumer goods. There is no reason to anticipate a departure from this policy in the future. Among the reasons for this practice may be noted, first, the remarkable steadiness of demand regardless of the price, a condition known to the economists as "inelastic demand"; and second, the presence of more or less active moralistic sentiments, including the belief that high prices for these products contribute to greater moderation in use.

The position taken here is that there is nothing either illegal or immoral about the production, sale, or use of alcoholic beverages or tobacco (except as individual states may exercise their constitutional prerogative of forbidding manufacture and/or sale of specified alcoholic beverage products). The practical problem to be faced in the development of this program may be stated thus: Granted that alcoholic beverages and tobacco are destined to be taxed somewhat out of line with other goods, by which jurisdiction should the taxes be levied, and to what level should the tax burden be held?

This double-barreled question must be dealt with from a long-range viewpoint, and also from that of existing, practical realities.

As a long-range matter, and taking into account all of the balancing factors in a thorough-going re-allocation of tax resources, it would be desirable to give the federal government exclusive jurisdiction over the liquor and tobacco taxes. The principal reason for this position is that the federal budget is in far greater need of steady, reliable sources of revenue than are the state budgets. A deficit in any public budget is unfortunate and to be avoided if possible; but when such a condition occurs in a state or municipal budget, its consequences are far less serious for the whole economy than when it occurs in the national budget. In the latter case it is almost certain to lead to a permanent increase of the public debt and to the creation of inflationary conditions which have even worse effects than bad taxation.

Because of the steadiness and reliability of the liquor and tobacco

taxes, it would therefore be desirable and advantageous in every way if an arrangement could be made whereby the full tax contribution that may be determined to be proper for consumers of liquors and tobacco to make could be taken into the federal treasury. If further federal deficits, and the resultant possibility of inflationary financing were thereby to be prevented, or minimized in scope, the advantages to the economy and to the ability of all states to support their own operations, would outweigh in the long run any benefits which they might derive from retention of these taxes.

On the other hand, since the repeal of the 18th Amendment in 1933, all of the states except those which elected to retain prohibition, have either developed their own license and excise taxes on alcoholic beverages or they have monopolized the sale of some or all such goods; and a number have introduced, also, taxes on cigarettes and other tobacco products. Total state revenues from such taxes — and profits — were about \$1150 million in 1949. The state tax rates vary considerably, as does the relative importance of these revenues. But the aggregate contribution to state receipts is impressive, and it presents a practical problem of negotiation and adjustment of such proportions that it can only be indicated here, with no thought that a solution acceptable to all sides can be found by 195X.

The second aspect of the above question, viz., how much tax should the consumers of these products pay, admits of no absolute answer. It is common knowledge that as liquor prices go higher, there is a stronger incentive to illicit production and a wider margin of illicit profits for the "purchase" of protection. Both federal and state tax rates are at the highest levels ever applied in this country, and there is considerable evidence that in combination they have created a price structure quite favorable to illegal operations. The last increase of federal cigarette taxes was in 1942, from \$3.25 to \$3.50 per 1,000. The last increase of the tax on distilled spirits was in 1943, from \$6.00 to \$9.00 per gallon. The beer tax was raised in 1943 from \$7.00 to \$8.00 per barrel.

One way of measuring the adjustment of the tax load would be by eliminating these last federal tax increases. At present consump-

tion levels this would decrease federal revenues by about \$575 million. Another measure of the adjustment, useful for the long-range situation rather than for immediate application, would be to state it in terms of the elimination of the state taxes, now about \$900 million. This would be equivalent to a 25 percent overall reduction of the consumer burden.

In view of the commitment made in connection with the 1943 emergency increases for their early repeal when the war was over, there is force in the arguments for taking this step. No assurance can be given, however, that it would afford corresponding tax relief, for some states might be tempted to increase their own taxes as the federal reduction became effective. It is to be hoped, however, that the prospect of greater tax resources to be made available to all of the states in the program offered here, would deter them from such a course.

The case for some moderation of the total tax burden on the consumers of liquors and tobacco must rest on the general ground of relatively equitable treatment, rather than on any expectation that greater consumption would result. This follows from the inelastic demand which is characteristic of the consumer attitude toward these products. That is, assuming that any reduction of either the liquor or tobacco taxes were passed in full directly and immediately to consumers, there is as much reason to expect that the tax saving would be devoted to the purchase of other things as there is to believe that it would result in the purchase of more liquor or tobacco.

This is a point of general application in connection with the tangled excise tax situation that is often overlooked. There is no evidence to show that reduction or repeal of any of the existing high excise taxes would result in a permanent additional expenditure of the tax savings for more of the same kind of goods. A temporary spurt of sales might occur because of purchases delayed in anticipation of the reduction. Aside from such a transient situation, it is fully as reasonable to expect that excise tax reduction from existing rate levels would lead to a general review, by consumers, of their spending programs.

This gives emphasis to certain aspects of the psychology of consumption which deserve consideration.

That is, the possession of more income for spending creates a disposition to buy with less regard for specific prices, whereas restricted income is a deterrent to spending even if prices are reduced. The degree of reduction proposed here for the federal tax on individual incomes will, by raising the "take-home" income, promote greater readiness to spend for consumption purposes even if the goods bought are subject to moderate excise taxes that are part of the price. Generalizing on this point, it is better for all lines of business that income taxes be reduced and thus to let the people have more of their own income to spend while spreading part of the tax load across the board by a moderate general excise, than it is to make everybody feel "poor" under a heavy income tax drain and expect them to buy a large volume of goods even with no excise tax included.

In the tax program presented here it is not proposed, however, to increase the absolute amount of revenue to be received by the federal government from excises. On the contrary, the aim is to hold the total at approximately the present level, but the proportion of excise tax receipts in the grand total will be larger than at present because of the decline that is proposed in the individual income tax payments, and in total federal receipts.

Repeal of All Other Federal Excise Taxes.

The present list of articles subject to federal excise is a product of successive enactments, each of which added more things to the taxable list. The rates were changed from time to time as the war pressure for revenue increased. The result is that there is no logical or consistent pattern in the selection of goods to be taxed, and no regularity in the scheme of tax rates imposed. This part of the federal tax system may very properly be described as a "hodge-podge." It has been productive of much complaint, an important and thoroughly valid ground for which is the discriminatory character of the present system. There is presented, in Table X, the list of goods and services which are now taxable, except liquors and tobacco, with the rates of tax presently applicable.

TABLE X

RATES AND YIELD, 1949, OF MANUFACTURERS', RETAILERS'
AND MISCELLANEOUS EXCISES^a

Item	Basis of Tax	Rate	Yield, (000)
AD VALOREM RATES			
Photographic apparatus	manufacturer's price	25%	\$ 43,140
Long distance, telegraph, radio, cable	charge to consumer	25	311,380
Electric light bulbs and tubes	manufacturer's price	20	26,172
Lease of safe deposit boxes	charge to consumer	20	9,461
Admissions to theaters, cabarets, etc.	" " "	20	434,700
Club dues and initiation fees	" " "	20	27,790
Furs	retail price	20	61,946
Jewelry	" "	20	210,688
Luggage	" "	20	82,607
Toilet preparations	" "	20	93,969
Photographic films	manufacturer's price	15	See above
Local telephone service	charge to consumer	15	224,531
Transportation of persons, seats, berths	" " "	15	251,389
Firearms, shells, and cartridges	manufacturer's price	11	10,379
Pistols and revolvers	" "	11	810
Electric, gas, and oil appliances	" "	10	80,935
Musical instruments	" "	10	9,293
Radio sets, phonographs, com- ponents, records	" "	10	55,643
Mechanical refrigerators, air- conditioners, etc.	" "	10	77,833
Business and store machines	" "	10	33,344
Sporting goods	" "	10	19,846
Wire and equipment service	charge to consumer	8	See above
Automobiles and motorcycles	manufacturer's price	7	332,812
Trucks and Buses	" "	5	136,797
Automobile parts and acces- sories	" "	5	120,138
Transport of oil by pipeline	charge made	4½	19,325
Electrical energy	taxable sales	3⅓	79,347
Transport of property	charge made	3	337,030
OTHER RATES, SPECIFIED BY UNIT			
Gaming coin-operated device	each device	\$100	21,088
Amusement coin-operated device	" "	10	See above
Bowling alleys, pool tables	each alley or table	20	3,805
Adulterated butter	pound	10¢	21
Oleomargarine, colored	"	10¢	17,541
Oleomargarine, uncolored	"	¼¢	See above
Inner tubes	"	9¢	26,250

Item	Basis of Tax	Rate	Yield, (000)
OTHER RATES, SPECIFIED BY UNIT, <i>Cont'd</i>			
Lubricating oil	gallon	6¢	81,760
Matches, colored wooden stems	1,000	5½¢	8,737
Tires	pound	5¢	124,649
Transport of coal	ton	4¢	See property
Processed vegetable oils	pound	3¢	17,460
Matches, not colored, stemmed	1,000	2¢	See matches
Gasoline	gallon	1½¢	503,647
Filled cheese	pound	1¢	See butter
Processed or renovated butter	pound	¼¢	See butter
Total collections			\$3,896,253

a. This list does not include the stamp taxes on the issue, transfer, or recording of documents, and on playing cards. The total yield of these taxes in 1949 was \$72,828,000. The sugar tax and the regulatory taxes on machine guns, silencers, and narcotics are also excluded.

The list of articles subject to the federal excise is arranged according to the rates of tax. In some cases the data on tax yield are combined in the Treasury reports. Attention is directed to the numerous cases in which the amount of tax is so small as to be more of a nuisance to the taxpayers and the Treasury than a help to the revenue.

The table provides eloquent testimony as to the erratic, hit-or-miss character of the federal excises. The selection appears to have been determined by a curious blend of revenue considerations, a peculiar conception of luxuries, and traces of moralistic control. It should hardly be necessary to argue the advantages to be realized from clearing away the entire hodge-podge list and introducing a more consistent, uniform system.

It is an accepted principle of the free competitive market that all producers should have access to it, and that all consumers be unhampered in their spending choices. This does not mean that everything must sell for the same price, or that there cannot be regional or commodity price differences. It does mean, however, that the policies of government should not introduce discriminations which distort the freedom of market access among producers, and the freedom of market choices among consumers.

The present excise tax system is a selected list of such discrimi-

nations and distortions. From the standpoint of this particular method of taxation, there is no way of achieving equity — or equality — among competing producers, or among consumers of different products, except in one of two ways. The first way would be to repeal all excises, the second would be to subject all consumer goods to a uniform excise tax.

The choice between these alternatives is clear. The first method is excluded by the tremendous loss of revenue that would be involved, now upwards of \$4 billion apart from the liquor and tobacco taxes. Replacement of this revenue loss could not be effected by higher individual and corporate income taxes without crippling effects on the whole economy. It can be laid down as a general principle that, since all taxation is burdensome, the taxes that must be imposed to provide the necessary public funds should be so devised as to involve the minimum impediment to the prosperity and growth of the economy. That is, there should be the least possible restraint of, and interference with, both production and consumption. Income taxes, in general, affect the incentives and the capacity to produce income. Excise taxes are aimed at the use of income for consumption purposes. Excessive rates of income tax hinder production, limit the savings available for capital formation, and hence tend to restrict employment. Excessive rates of excise tax would cut down on consumption. A major objective of the overall program, one feature of which is being discussed here, is the achievement of moderation in both income and excise taxes, but in order to attain this result, it is plain that both types of tax must be used, so that the rates of both taxes may be moderate.

A further reason for retaining a substantial revenue from excise or consumption taxes is that they are relatively stable in yield under varying business and economic conditions, in contrast with the comparative instability of the income taxes. At given rates, their yield does not expand greatly under boom conditions, and hence they do not offer as great temptation to embark on large spending programs as do the income taxes which tend to soar in periods of prosperity. On the other hand, their resistance to depression supports the revenue in depressed conditions, and hence they become a bulwark against resort to deficit financing. From this charac-

teristic a good case can be made for increasing the proportion of total federal revenues provided by the indirect, or consumption taxes. Even without increasing the total revenue from this source, the proportion of excises in the total will be increased under the program offered here, by reason of the diminished dependence on the income taxes.

Certain broad aspects of the situation which the social economy faces are also worth considering. Notably, the population increase of recent years is a fact that must enter into long-range tax programs.¹ A decade ago there were many who forecast that this nation was on the threshold of "economic maturity." These forecasts were based in no small degree on the assumption, then currently accepted, that the population was rapidly approaching a stabilization point. It was asserted, on the strength of these population projections, that there would be no need for large additions to capital, and that investment opportunities would progressively dry up. The main emphasis was therefore laid on consumption and the ways of sustaining consumer purchasing power.

The population trend of the past decade has completely upset all predictions concerning economic maturity. As Dr. J. S. Davis has recently said:² "Indeed, had these (i.e., the population developments of the 1940's) been roughly foreseen, the doctrine would probably not have been put forward." In consequence, the views regarding an early limitation on the growth of the nation's capital requirements must likewise be recast.

These matters have a direct bearing upon the subject under discussion here. The millions of new workers must have jobs and this will require an even larger accumulation of capital than anyone had heretofore deemed necessary. If the goal of reasonably full employment for an expanding labor force is to be attained, there must be especial concern to avoid over-stress upon the taxes which so obviously impair both the capacity and the incentive to create capital, that is, the income taxes. At the same time, the vast broadening of consumption spending to be made possible by the maintenance of a growing labor force at high employment levels will permit the

¹ Cf. Joseph S. Davis, "The Population Upsurge in the United States," *War-Peace Pamphlets*, Food Research Institute, Stanford University, December, 1949, No. 12.

² *Op. cit.*, p. 84.

derivation of a still greater proportion of the federal revenue from a moderate rate of excise tax.

A Manufacturers' Uniform Excise Tax.

From the premises stated above, namely, that the excise tax discriminations should be ended and that there should be at all times a substantial dependence upon this form of revenue, it follows that the most direct and effective way to solve the problem is to replace the present selective, discriminatory system by a general tax, applicable at the point of final manufacture and imposed at a moderate, uniform, flat rate.

The specific recommendation that is made here with respect to the manufacturers' uniform excise tax is that it be in substitution for all of the taxes shown above in Table X, that it apply to all final products of manufacture except food and food products, alcoholic beverages and tobacco, and that it be levied at a rate to produce about \$4.0 billion in revenue. At present and prospective volumes of production, it appears that a uniform rate of 5 percent would provide the necessary yield.

The first point to be noted is that the proposed tax would be a substitute or replacement tax. The excises scheduled for repeal produce about \$4 billion at a capricious scale of rates, from a discriminatory, selective list of taxable goods and services. A general tax, levied at a uniform rate, would remove the caprice and terminate the discrimination. It would put all manufacturing on an equal, nondiscriminatory basis, and thus would not interfere with any competitive situation to anything like the degree that the present system does.

It is recommended that this tax shall not apply to food and food products. In general, a policy of exemptions from any tax requires careful restriction and control, for each case granted creates the ground for further extension and eventually the tax base is whittled to small dimensions. Largely for reasons of expediency, it is proposed that foods and food products be exempted because of the importance of the expenditures for these goods in all family budgets and, in particular, those of the smaller incomes. Even here, however, it would be desirable, if administratively feasible, to limit the exemption to the food articles and materials bought for home

preparation and consumption. There is less reason for extending it to the articles bought by restaurants, night clubs, and other public eating places, for preparation and sale to their customers, but the administrative difficulties encountered in making the distinction at the manufacturers' level would probably militate against it.

The exemption of food — and the fact that rent is a service, not a commodity, and hence not to be included in the base of the proposed manufacturers' uniform excise tax, — would mean that the expenditure of a substantial portion of the small incomes would not be affected by the tax. Even with respect to such part of the consumption expenditure of an individual or a family as may be made for articles subject to the tax, the payment of tax is not a regularly recurring obligation as in the case of the income tax, but one which is made once for all at the time of a given purchase. No one family buys a new car, refrigerator, or washing machine every year. The timing of the purchase, and hence of the excise tax payment, is under the control of the consumer. While no data are available as to the probable distribution of consumer purchases by income groups, it is apparent that a tax of this description could not be a serious burden upon any individual for the simple reason that individual incomes are limited and the margin available for the purchase of taxed articles is not great in any particular case. The large volume of total consumer spending is a result of the fact that there is a large number of consumers, each of whom contributes only a small quota to the total. Hence, the tax would be spread evenly but very thinly over a huge total of consumer spending and over a large number of individual contributors.

The theory of the proposed manufacturers' uniform excise tax is that it should apply to those end products of manufacturing which are in the form of, and destined to the ultimate use of, consumer goods. Following the precedent of the present federal manufacturers' excises, no tax would be imposed on any vendor in any case where the vendee bought the article for incorporation into a product which was itself to be resold. In other words, the inter-business sales of wholly or partially fabricated articles and materials to other manufacturers, by whom these goods were to be assembled or further processed into a final consumer good, would not be taxable.

The tax would be payable when the finished goods finally leave the manufacturing process and move into the channels of trade and distribution. The tax base would be the final manufacturer's sale price.

Control of the tax liability could be determined by an extension of the exemption certificates provided for by present law, or by the Canadian method of issuing licenses to all manufacturers.³ The operation of both methods is much the same. In Canada, sales to licensed manufacturers are not taxed, and the tax applies when a sale is finally made to an unlicensed dealer or operator. In the United States, the seller must secure an exemption certificate from his customer, otherwise the tax applies. The customer, or vendee, cannot obtain such a certificate except on a showing that the goods bought are to become a component part of some article in a further stage of processing or assembly, or are to be sold to another by whom such use will be made. Canada licenses wholesalers if more than fifty percent of their business consists of sales to licensed manufacturers.

Arguments Regarding the Manufacturers' Uniform Excise.

There are certain stock objections that are regularly encountered in any discussion of excise taxes. It is very likely that they will be invoked as arguments against the recommended uniform manufacturers' excise. Accordingly, they are dealt with briefly here.

First, it will be said that this is a new tax, and it will become just another tax on top of all we now have. The fact is that it is not a new tax. The federal government is now using a manufacturers' excise. It can be identified in Table X by the term "manufacturers price" in the column headed "Basis of Tax." In 1949, the few classes of products covered, which were taxed at rates ranging from 10 to 25 percent, produced \$1,772 million, or almost half of the amount which it is proposed here to provide from a moderate uniform rate on all end products of manufacture except food, alcoholic beverages, and tobacco.

It obviously does not make good sense to imply that the Congress would ever adopt a uniform manufacturers' excise tax in addi-

³ The Canadian tax and the arrangements referred to are described in the NAM publication, *The Canadian Excise Tax System*, by H. L. Lutz, 1948.

tion to the selective, discriminatory excises now levied. This program is offered as a way to end discriminations and complaint. The proposed tax is in substitution for the existing hodge-podge, and it is believed that the longer the Congress and the people consider the difficulties involved in clearing up the excise tangle, the more attractive a simple solution such as this program offers will become.

Second, it will be said the proposed manufacturers' excise tax will be pyramided. In considering excise taxes generally it must be recognized that by and large they are passed along to the final consumers. There may be cases of complete or partial absorption along the way but they are probably rare. The result of this shifting is that the consumers pay more for the goods bought than they would be asked to pay if there were no excises. A very large part of the \$4 billion now being collected through manufacturers', retailers' and miscellaneous excises is entering today into the prices paid by consumers. And in many instances, the prices of the particular classes of goods subject to present taxes are higher, by reason of the existing rates, than they would need to be under the proposed moderate rate. The merit of a general, uniform, moderate tax, in this connection, is that it would avoid the distortion of competitive situations which is necessarily produced by the present selective, discriminatory system.

The matter of pyramiding the tax as goods pass down from one layer to another of the distributive organization has been exaggerated. If this were consistently done, the practical result would be that profits at the several distribution levels would be greater than they would be if there were no such tax. And it would follow, also, that the higher the rate of tax, the greater the middleman profits would be. This view disregards the source and reason for profit, which is a return that is gained from the successful performance of a service that others are willing to pay for. In the field of merchandise distribution, this service consists essentially of supplying to consumers the kinds and qualities of goods that they want, at prices they are willing to pay. The value of this service, from the consumer standpoint, is not enhanced by the fact that the various middlemen are acting, in turn, as relays in a tax collection process. The competition for the consumer dollar in which all of the thousands of merchants and other distributors are

engaged is the effective determinant of the profit rewards which any of them will get. It is not a question of the ultimate consumer being the one from whom the tax, long since advanced to the Treasury, will be collected. Rather, it is a question of the extent to which there will be widespread, abnormal enhancement of profits at any level of the distribution process because of the tax. This is the point that has been exaggerated. Were it really true that all distributor profits would be enhanced by reason of such a tax, there should be a universal demand from these groups for a high tax rather than a low one. Actually, they know that a high tax would diminish both their sales and their profits. The advantage of a low rate across the board is that it does not discourage sales unduly, and it tends to keep the general competitive situation in a state of balance, so far as concerns all classes of goods, all producers, and all consumers.

An offset to the fact that excises tend to cause consumer prices to be higher than they would be otherwise is the greater amount of take-home income which workers generally would have because of the reduction of income tax. Both elements in the overall program must be considered together. It was said above, and is worth repeating, that as a matter of psychology, there is probably a greater restraint on the willingness, or propensity, to spend from the curtailment of income through heavy income tax than there is from somewhat higher prices if at the same time expendable income is increased. In other words, income tax reduction plus a moderate amount of excise tax is probably a better combination for the promotion of consumption spending than is the combination of heavy income taxation and light or no excise tax. Obviously, the only way to assure the income tax reduction is by retaining a sufficient volume of excise taxation to make that result possible.

Third, it will be said that the proposed tax will be regressive. This argument is often advanced against excise taxes generally, although it is more frequently used when the disputant happens not to like or approve of a particular tax than it is as a general principle. The term is commonly used to mean that the tax on a given amount of purchase is a higher proportion of a small than of a large income. This is correct. It is also true, although usually overlooked in the argument, that the purchase price of a given article

is itself a larger proportion of a small than of a large income. In other words, the complaint which is lodged against the tax could, with even greater force, be lodged against the whole system of market prices. There is no practical way, in a free economy, by which the system of prices can be so modified as to produce a different result. The implication of the criticism directed against the excise tax is that it involves some sort of unique oppression of the small incomes. By this standard there is a far greater degree of oppression in the whole price system than there can be in a tax which is ordinarily only a small proportion of the price. But there is no evidence of such oppression. Living costs have not been easy to meet, in periods of rapidly rising prices. Nevertheless, everyone has shared increasingly in the prosperity of an expanding free economy which has always been characterized by a "regressive" price system. A moderate, uniform excise tax would not impede or dampen that prosperity as much as would the heavy income taxes that must be retained unless they can be reduced by the program offered here.

Fourth, it will be said that the proposed tax will be a "hidden" tax. There has been much discussion, recently, about so-called "hidden" taxes. The implication has been that hidden taxes are bad, and indicate that some kind of nefarious practice has caused something to be hidden that should not be.

It would be well, at the outset, to understand just what the term "hidden tax" means. It is ordinarily used to describe those cases in which the person who bears the burden of a tax is not directly aware of its existence or its amount. The actual taxpayer, who makes the cash payment to the collector, is always informed on both of these matters. When the burden of the tax is passed on to someone else by the process of tax shifting, it usually happens that the tax loses its identity and becomes simply a part of the price subsequently paid for goods or services.

As thus defined, it is evident that there is a large amount of hidden taxation, for there is undoubtedly a large amount of tax shifting. Such shifting is found in local and state taxation, as well as in federal taxation. There is a substantial shifting of the local property tax, for example, in the case of property used for business and in-

come purposes. The merchant who pays property tax on his store building, fixtures, and stock in trade must recover this item of cost, along with all other costs, from his customers. In pricing merchandise, there is no separate identification of the tax element allocable to each separate item sold, and hence the merchant's local taxes are hidden, in the sense usually given to the term.

In the same way, many taxes levied by state governments, and the excise taxes levied by both state and federal governments, are hidden. There is not, and cannot be, a separate billing and identification of these taxes through all of the ramifications of trade and distribution. In general, it can be said that all taxes which enter into business costs will be shifted, unless competition or other business conditions, e.g., a serious depression, makes this impossible. The result is that there are only a very few taxes which always remain out in the open, the most prominent and obvious ones being the individual income tax and the retail sales tax.

In view of this situation, which is not new but has always existed, it is of interest to know the reasons for the recent extensive agitation about hidden taxes. Two reasons or motives have been prominent. One is that the semantically bad term "Hidden Tax" has proved an effective slogan in the drive against the federal excises. The other is that some who have despaired of bringing public spending under control have sought to explain taxpayer indifference by emphasizing hidden taxation and they believe that this situation can be corrected by developing "tax consciousness." With respect to both of these motives, there has been much confusion of thought, and of means with ends. The lack of logic becomes apparent when one accepts either of the above motives and carries the argument through to its conclusion.

For example, if a hidden tax is really a bad tax, then it follows that all of the federal excises except the four collected at the retail level (on furs, jewelry, luggage, and cosmetics) should be eliminated. This would leave, for federal support, only the income taxes and the retail excises. In fact, there is wide divergence of views among businessmen regarding the corporation income tax, some insisting that it is passed along to consumers, and insofar as this may happen, it, too, becomes a hidden tax. Others hold that its burden is on the shareholders. But if the criticism of hidden tax-

ation is sound and sincere, it follows that a large proportion of both state and local taxation comes under the ban also. While it is true, as a general economic proposition, that all taxes are paid out of income, it is not possible, nor is it desirable, to abolish all methods of taxation for local, state, and federal purposes except direct taxes on individual income and retail sales taxes. The reasons why this cannot and should not be done are numerous and persuasive, but are not given here.⁴ In view of the end to which the general attack on hidden taxation leads, it becomes necessary to take a fresh look at the charge that this kind of taxation is bad.

The most important test of the quality of a tax is its effect on the growth of the economy. And viewed in this way it appears that the measure of tax effects is more likely to be the rates of tax than the kind of tax. The country grew from its colonial beginnings to its present size and economic capacity without producing evidence of suffering or injury from an array of taxes that were in more or less degree hidden. It has only become more clearly evident that the destructive character of taxation lies in the rates rather than in the kinds of taxes levied as the spending and taxing have risen to such abnormal levels as have been experienced during the present generation.

Or suppose that the argument of tax consciousness be followed through to its conclusion. This may be regarded as the intellectual basis of the opposition to hidden taxes. It involves the belief that when the citizens are fully aware of the taxes they are paying, they will become more ardent in demanding greater economy in government. This is a pious hope, for which all too little supporting evidence from experience can be found. It is possible to develop that state of mind called "tax consciousness" by appropriate techniques of agitation and promotion, but there can be no assurance of a citizen reaction in the particular direction of a demand for greater governmental economy. It can, and often does, strike in some other direction. The English excises of the 18th Century aroused a very active tax consciousness in the people, but it led to extensive smuggling, and frequent attacks on the excise tax collectors with lethal weapons. There was no demand for greater economy. A retail sales

⁴ Cf. *A Tax Program for a Solvent America*, 1945, Chapter 7, by the Committee on Post-war Tax Policy.

tax was adopted in New Jersey in 1935, and very active tax consciousness was speedily aroused. It led to prompt repeal of the tax rather than to greater economy in the state government.

Now it is obvious that the only feasible way of managing the excise taxes is to treat the tax as an inclusion in, or as an addition to, the price. And with respect to the latter alternative, the tax rate must be uniform or this method becomes unworkable. For example, by long custom and established practice, alcoholic beverages and the various forms of tobacco product are set apart for heavier taxation than is levied in this country through retail sales taxes. It would not be administratively feasible to undertake to collect, at the retail level, separate rates of tax on the various kinds of alcoholic beverage, and on each of the various forms into which tobacco is made for smoking or other uses.

The principal question therefore is — Is there something so inherently bad about the inclusion of certain taxes in the prices of goods or services that the situation must be corrected at all cost? In the writer's opinion this is not the case. It has been shown above that the major argument for having taxes out in the open rests on wishful thinking rather than on the solid results of experience. People are inclined to be apathetic about taxes until they are aroused through means and measures deliberately designed to produce intended results. Home owners do not attend municipal budget meetings in throngs. Income tax payers, voting as a group, could carry any election in favor of economy, but they have never carried any election except the first one — the one by which they saddled themselves with the income tax.

The payment of tax as part of the purchase price — actually it is a reimbursement by the ultimate consumer for a tax payment made at some earlier state of production — is not an evil in and of itself if we accept the philosophy that it is proper to pay some tax as income is spent. If this philosophy is rejected, then it would follow that we are forced to the position that all taxes should be paid as income is received. For many reasons which have been developed in full elsewhere and hence need no repetition here, the concentration of all taxes on income as received would be disastrous for the maintenance of vigorous production, and it would put the federal finances in an extremely vulnerable position, particularly with

respect to the variations of business activity between boom and recession.

It is readily granted that the collection of federal excises, other than those on alcoholic beverages and tobacco, at the retail level as a retail sales tax, would be the most desirable procedure. This is not simply because the tax would then be out in the open, although the advantage of this fact is evident. At the retail level there would be no question of carrying charges on cash advanced to the Treasury at some earlier time, and none, either, of pyramiding on the tax as an element of cost at earlier distribution states. Notwithstanding these obvious advantages, the levy of tax at the final state of manufacture has been selected instead, for other reasons which seemed persuasive in the light of all the circumstances connected with the use of retail sales taxes by the states.

Coming back to the specific matter of hidden taxes, it is reasonable to believe that when all consumer goods except foods, alcoholic beverages and tobacco are known to be subject to a single, uniform rate of excise, there will be little excuse or reason to refer to it as a hidden tax. Granted that few people can remember all of the details of the present complicated and illogical excise rate structure, there would be no comparable reason why every one should not be aware of, and remember, one single rate that is applicable across-the-board.

By way of summary, the reasons for recommending a manufacturers' uniform excise tax in substitution for the present selective, discriminatory system are:

First, it would eliminate the existing discriminations in coverage and rates.

Second, by sustaining the proportion of total revenue to be derived from this type of tax, it would render the federal revenues more stable under varying conditions and permit a relative reduction of the income taxes.

Third, a reduction of the burden of the federal income tax, particularly on individual incomes, would release citizen income in every state and thus enable all of the states to assume service responsibilities now carried, at far greater cost, by the federal government.

Fourth, a general, uniform tax would maintain as nearly as pos-

sible the established competitive positions among producers and their products.

Fifth, a tax levied at the final stage of manufacturing would minimize the mark-up of costs, by reason of the tax, in the subsequent transfers to consumers. In some respects the retail sale would be a more appropriate point for the tax levy. It would be unwise, and no doubt politically impossible, however, in view of the extensive use of retail sales taxes by the states, to duplicate this tax at the federal level. Moreover, it would be a violation of one general aim of the overall program which is the avoidance, where possible, of duplicating taxation.

A matter of vital interest and concern to all is the rate that would be required to produce the revenue required. In the preliminary discussion stage of the overall program, it is proposed that the goal be set at \$4.0 billion. Further exploration of the extent to which the federal spending could be reduced in connection with a program of functional re-allocation, and taking into account the large possibilities of reduction through the termination of present extraordinary commitments, may reveal that this goal is higher than would be necessary.

No current data are available to indicate the volume of unduplicated or final manufacturers' sales at present national income levels. The Canadian revenues from a similar tax indicate that the base of taxable sales is about 35 percent of Canadian gross national product. Industrialization has proceeded much farther here than there, and it would appear, therefore, that the Canadian experience understates the ratio that might be expected here. However, assuming that a tax base of some 30 percent of gross national product would emerge, a tax rate of about 5 percent would suffice.⁵

Conclusions:

1. A reasonably substantial yield from excise taxes is a necessary part of an equitable and stable tax system.

⁵ The basic data are as follows:

Gross national product in 1948 was \$262 billion, according to the Department of Commerce. And if the tax base be assumed to be only 30 percent of gross national product instead of 35 percent, as the Canadian parallel would indicate, this base would be \$78.6 billion when gross national product is \$262 billion. A 5 percent tax would produce \$3.93 billion.

2. The present federal excise system is a hodge-podge, with discriminatory selection of taxable commodities and discriminatory rates.
3. Although certain excises are better suited than others for use at different levels of government, all levels use a number of the major excises.
4. At present and prospective volumes of production, a federal manufacturers' uniform excise tax of 5 percent would yield about \$3.93 billion, which would be roughly equivalent to current revenue from the present manufacturers', retailers', and miscellaneous excises, excluding alcoholic beverages and tobacco.

Recommendations:

1. A manufacturers' uniform excise tax at the federal level on all end products of manufacturing except food and food products, and in substitution for all existing manufacturers', retailers', and miscellaneous excises except those on alcoholic beverages and tobacco.
2. Exclusive local use of taxes on admissions, dues, coin devices, bowling alleys, documents subject to stamp taxes, safety boxes, etc.

CHAPTER 4

FEDERAL GASOLINE TAXES AND HIGHWAY GRANTS

In the program for the re-allocation of tax sources and service responsibilities, it is proposed that the federal government withdraw entirely from the taxation of gasoline and lubricating oils. It is also proposed that the federal grant system be sharply curtailed. In this chapter the relation between the respective state shares of the federal taxes and their highway grants in the fiscal year 1949 is examined. Table XI presents the amounts received by the several states as regular and emergency highway grants in the fiscal year 1949, and also an allocation to them of the total federal gasoline and lubricating oil taxes collected in that year.

TABLE XI
STATE SHARES OF FEDERAL GASOLINE AND OIL TAXES,
AND OF HIGHWAY GRANTS, 1949
(Thousands)

State	State share ^a , Federal taxes ^b , 1949	Federal Highway Grants, 1949 ^c
Alabama	\$ 8,020	\$ 4,591
Arizona	3,340	5,017
Arkansas	5,500	5,063
California	58,660	21,850
Colorado	6,560	9,610
Connecticut	7,320	3,196
Delaware	1,400	1,559
District of Columbia	2,870	4,178
Florida	12,240	5,703
Georgia	10,770	10,214
Idaho	2,870	3,202
Illinois	32,610	17,782

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State	State share ^a , Federal taxes ^b , 1949	Federal Highway Grants, 1949 ^c
Indiana	17,330	7,607
Iowa	13,930	9,583
Kansas	10,950	9,912
Kentucky	8,200	5,878
Louisiana	7,670	5,097
Maine	3,400	2,819
Maryland	7,550	4,662
Massachusetts	14,400	6,857
Michigan	27,630	17,106
Minnesota	13,520	11,773
Mississippi	6,210	8,350
Missouri	16,390	10,809
Montana	3,340	6,576
Nebraska	6,560	5,810
Nevada	1,050	4,367
New Hampshire	1,930	2,170
New Jersey	18,730	10,808
New Mexico	3,160	5,249
New York	38,460	16,470
North Carolina	13,000	10,013
North Dakota	4,100	6,617
Ohio	32,200	11,730
Oklahoma	10,130	6,994
Oregon	7,490	6,886
Pennsylvania	32,310	24,041
Rhode Island	2,460	2,272
South Carolina	6,560	4,716
South Dakota	4,160	7,112
Tennessee	9,830	12,630
Texas	42,970	29,516
Utah	2,930	4,084
Vermont	1,460	1,857
Virginia	11,650	5,816
Washington	9,830	5,457
West Virginia	5,500	2,856
Wisconsin	14,340	13,118
Wyoming	1,930	5,330
	\$585,420	\$404,913

- a. State shares of the federal taxes represent an apportionment based on estimated gasoline consumption in each state during the year. It is assumed that the consumption of lubricating oils would be proportionate to the gasoline use.
- b. Total taxes on gasoline and lubricating oils, from *Report of the Commissioner of Internal Revenue*, 1949, Table 1.
- c. Federal highway grants include regular and emergency grants, from *Report of the Secretary of the Treasury*, 1949, Table 98A.

In fifteen states and the District of Columbia the federal highway grants exceeded federal taxes on gasoline and lubricating oils in 1949. This situation is likely to vary from year to year. The jurisdictions that were contributing less tax than the highway aid received in 1949 fall into three groups: eight public domain states, three marginal states, and four states which, together with the District, were rather seriously behind in taxes relative to grants. The eight states which include large areas of the public domain, meaning the lands to which the title is still vested in the United States, are shown in Table XII.

TABLE XII

PROPORTION OF FEDERAL LAND OWNERSHIP, AMOUNTS
OF FEDERAL HIGHWAY AID, AND STATE SHARE OF
FEDERAL GASOLINE AND OIL TAXES, 1949
(Thousands)

State	Percent, Federal Land Ownership	State Share of Federal Gasoline and Oil Taxes	Federal Highway Grants, 1949
Arizona	73	\$ 3,340	\$ 5,017
Colorado	38	6,500	9,610
Idaho	64	2,870	3,202
Montana	35	3,340	6,576
Nevada	87	1,050	4,367
New Mexico	44	3,160	5,249
Utah	72	2,930	4,084
Wyoming	51	1,930	5,330
Totals		\$25,120	\$43,435

There are three other states in which the proportion of federal land ownership is high, namely California (46%), Oregon (53%), and Washington (35%). In these states the development of population and resources has evidently been such as to raise consumption to a level that would keep them out of the deficit column with respect to the relation between taxes and grants.

In the three marginal states (Delaware, New Hampshire and Vermont) the total excess of grants over taxes in 1949 was \$796,000. This is not a serious situation and the balance is so close that it can easily vary from one side to the other in different years. In the four states with more serious deficiencies of taxes relative to grants

(Mississippi, the Dakotas, and Tennessee) and the District of Columbia, the total shortage of taxes in relation to highway grants in 1949 was \$11,717,000.

The conclusion which appears warranted from the most recently available data is that the program of repeal of the federal gasoline and oil taxes, and suspension of the federal highway grants, would leave a highway grant deficit problem of only negligible proportions. On the other hand, the 33 states from which more was collected in taxes than was paid back in grants would benefit materially in the aggregate. In 1949 these states supplied \$528.3 million of the taxes and received \$317 million in highway grants.

There has never been an obligation, expressed or implied, that all of the revenue from the federal gasoline and oil taxes should be distributed as highway grants. From their inception, the gasoline and motor vehicle license taxes at the state level have been quite generally devoted to highway construction and maintenance purposes. One argument used to support federal invasion of the gasoline tax field has been that the funds for the grants would thereby be provided, but this viewpoint has never received widespread support. The plain fact about the highway grants is that they constitute another instance of federal control over an activity, namely road building, which is actually performed by the states or their local governmental units. This work would be as well done, and for the most part as well planned, if there were no federal interference or control at all. By whatever means the several states might elect to provide funds equal to the present highway grants, it would not be necessary to collect as much from the citizens as they are now paying in gasoline and oil taxes to the federal government.

The question of highway grants, like all other grants, involves various matters which are usually dealt with on an emotional basis rather than objectively. It is assumed, for example, that because there was a case for federal aid and federal leadership in pushing through to completion a national network of hard-surfaced roads after the motor vehicle was rendered reasonably foolproof and was turned out in great numbers, there is still a case for perpetuation of the grant system.

There is general agreement among students of highway trans-

portation that the principal need today is not for more transcontinental roads, but rather for local facilities to relieve traffic congestion in and around urban centers. In a study made by the National Resources Planning Board in 1942, it was shown that motor traffic is composed chiefly of short-run movements. Thirty percent of all traffic consisted of local trips entirely within city limits. Eighty-five percent of all passenger car trips and eighty percent of truck trips were said to be less than twenty miles one way.

In support of this viewpoint the following excerpt from the Board's report is pertinent:¹

The highway problem, then, involves the task of providing facilities to permit safe, speedy, low cost transportation mostly of a short-run nature, by thirty-two million vehicles. The solution is encompassed in no one remedy, but rather in a host of related factors which together constitute highway policy.

Pertinent, also, is the same Board's comment on the "superhighway" schemes:²

Commonly associated with the term "superhighway" are the visionary proposals for transcontinental routes frequently made in connection with plans for large-scale public works. Promotion of coast-to-coast motor roads, however, generally derives from the philosophy that public works should have as their primary objective the furnishing of employment rather than the creation of additional wealth. Based upon this untenable assumption, the proponents of transcontinental schemes are able to overlook the fact that there exists no important volume of transcontinental travel, and that the real problem of providing facilities to move high traffic volumes at reasonable speed lies in a different direction.

These expressions add strength to the viewpoint that the principal highway need for the present and future is essentially local, in that it involves by-passes, widening of urban approach routes, elimination of grade crossings, and better parking facilities in cities. These are problems which state highway agencies can and should solve in their own way and with their own funds. A continued emphasis upon federal grants, with such degree of prescription as there may be with respect to the application of federal funds, is likely to divert local effort from these essentials to less vital purposes.

The contention has been advanced that the proposal to eliminate

¹ National Resources Planning Board, *Transportation and National Policy*, p. 385.

² *Idem*, p. 393.

federal highway grants would contravene Article I, Section 8, Clause 7 of the Constitution, which states that the Congress shall have power to establish post offices and post roads. The word "establish," as applied to post roads, appears to mean designate rather than build. Elimination of the federal highway grants would not interfere in any way with the Congressional authority to designate certain roads as post roads. The first of the modern highway aid acts, passed in 1916, limited federal aid to post roads, but it defined such a road as one over which the United States mails are, or may hereafter be, carried. At least two ante-bellum presidents who held strict constructionist views on the Constitution vetoed bills carrying appropriations in aid of road building.

In fact, the federal government does no direct road building, even today, except in the national forests, national parks, and military reservations. All other actual construction is initiated by, and done under the direct supervision of the states or their local units. The highway grant system was a useful device to assist the states in carrying through to a speedy conclusion the building of the great national highway network in response to the needs and demands of the first generation of motor vehicle development. It is no doubt true that there is ahead an immense task of reconstructing and modernizing these first highways. But the several states will be equal to this task if they are allowed to get the funds. Reduction of the federal tax load is the way to increase the tax potential of the various states. They can get more money for this purpose from their own taxes than they can get by letting the federal government levy the taxes and hand part of the money back as grants-in-aid.

The highway construction and maintenance problem in those states in which the federal government is still the owner of a large proportion of the land is peculiar and requires a different approach. It is true that much of the remaining public domain is unsuited to settlement and use, and the population in those sections will always be sparse. Hence, some of the states will probably never have the opportunity of developing the local resources necessary to provide and maintain modern highways across vast expanses of federally owned land. The case for federal participation in the cost of highways under such circumstances rests on the fact of federal pro-

prietorship rather than on any general philosophy of grants-in-aid. As long as this domain remains in federal ownership and control, it is equitable that there be federal participation in necessary highway costs, particularly with respect to the roads that traverse the domain.

* * * *

Conclusions:

1. In total, the states paid \$585 million in 1949 in gas and oil taxes to the federal government, but received only \$405 million in federal grants for highways.
2. Each of eight public domain states, where the federal government owns 35% to 87% of the land, received on the average a little over \$2 million more in grants than they paid in taxes.
3. Federal participation in highway costs in the public domain states is related to federal proprietorship and is therefore appropriate.
4. The overall case for federal aid for highways was originally based on a need for a national network of hard-surfaced roads, a need which has now largely been met.
5. The principal highway problem for the present and future is a *local* need and a local responsibility — that is, facilities to relieve traffic in and around urban centers.

Recommendations:

1. The federal government should withdraw entirely from the taxation of gasoline and lubricating oils.
2. The system of federal highway grants should be abolished, and the federal government's activities in this area should be limited to research, stimulus to state and local agencies, and overall leadership.
3. Some federal participation in highway costs is proper in certain public domain states.

CHAPTER 5

ALLOCATION OF ADMISSIONS TAXES AND CERTAIN OTHER TAXES FROM FEDERAL TO LOCAL USE

The program of allocation of tax resources and service responsibilities which was outlined in Chapter 1 contains various possibilities of readjustment that would be constructive and beneficial from the standpoint of a better balance between federal and state-local governments. The situation with respect to the federal gasoline tax and the highway grants has been presented in Chapter 4. It was shown there that a large number of the states would be fully able to deal with their own highway problems by foregoing the highway grants and taking for their own use part, or in some cases all, of the tax rate now collected by the federal government on gasoline.

The subject of this chapter is the repeal of the federal taxes on admissions, dues, lease of safety boxes, coin devices, bowling alleys, pool tables, and documentary stamps, to the end that local units of government, particularly the cities, may introduce such taxes for their own use. It is assumed that wherever necessary, the state legislatures would enact enabling legislation to this end.

By way of giving point to the revenue advantage to the municipalities from this proposal, there is given, in Table XIII, a comparison of the total federal collections under these taxes in 1949, by states, with the amounts proposed to be allocated to the states under the bill to establish a federal grant for aid to education (S. 246, 81st Cong., 1st Sess.). The amount authorized in the bill as it passed the Senate is \$300 million, but certain conditions set out in the complicated formula by which the several state shares are to be determined reduce the total allotment to \$274,810,000.

TABLE XIII

RELATION OF ADMISSIONS AND AMUSEMENT TAXES, 1949,
TO PROPOSED FEDERAL GRANTS FOR EDUCATION,
BY STATE
(Thousands)

State	Selected Taxes Col- lected ^a	Proposed Grant-in- Aid for Educa- tion ^b	States with	
			More taxes than aid	More aid than taxes
Alabama	\$ 4,121	\$ 17,390	—	\$ 13,269
Arizona	2,367	1,500	\$ 867	—
Arkansas	2,270	12,980	—	10,710
California	57,249	8,435	48,814	—
Colorado	6,017	1,240	4,777	—
Connecticut	5,389	1,685	3,704	—
Delaware	955	280	695	—
Florida	12,279	2,365	9,914	—
Georgia	6,930	15,860	—	8,930
Idaho	1,870	625	1,245	—
Illinois	42,264	7,490	34,774	—
Indiana	9,941	3,825	6,116	—
Iowa	7,702	2,625	5,077	—
Kansas	3,914	1,880	2,034	—
Kentucky	5,686	15,190	—	9,404
Louisiana	7,886	10,370	—	2,484
Maine	1,713	945	768	—
Maryland	12,527	2,010	10,517	—
Massachusetts	20,613	4,115	16,498	—
Michigan	23,049	6,235	16,804	—
Minnesota	9,897	2,920	6,977	—
Mississippi	1,973	16,980	—	15,007
Missouri	13,705	3,790	9,915	—
Montana	2,137	585	1,552	—
Nebraska	3,294	1,305	1,989	—
Nevada	1,768	125	1,643	—
New Hampshire	1,460	505	855	—
New Jersey	13,957	3,840	10,117	—
New Mexico	1,430	3,130	—	1,700
New York	132,001	11,925	120,076	—

State	Selected Taxes Col- lected ^a	Proposed Grant-in- Aid for Educa- tion ^b	States with	
			More taxes than aid	More aid than taxes
North Carolina	6,793	21,070	—	14,277
North Dakota	1,006	860	146	—
Ohio	30,442	7,320	23,122	—
Oklahoma	5,408	8,350	—	2,942
Oregon	4,916	1,410	3,506	—
Pennsylvania	30,336	10,120	20,216	—
Rhode Island	2,462	645	1,817	—
South Carolina	2,737	13,980	—	11,243
South Dakota	1,381	1,080	301	—
Tennessee	6,853	13,220	—	6,367
Texas	24,043	12,640	12,403	—
Utah	2,229	1,170	1,059	—
Vermont	806	420	386	—
Virginia	7,134	5,150	1,984	—
Washington	9,963	2,250	7,713	—
West Virginia	3,829	9,360	—	5,531
Wisconsin	9,808	3,325	6,483	—
Wyoming	996	290	706	—
Total	\$567,506	\$274,810	\$287,569	\$101,864

a. Source: Treasury Department, *Annual Report of the Commissioner of Internal Revenue*, 1949, Table I. Total derived from unrounded detail. Includes federal taxes on: admissions, club dues, safe deposit boxes, bowling alleys and coin devices, and all federal stamp taxes.

b. Source: *Senate Report No. 158, 81st Congress, 1st Session* to accompany S.246.

The taxes that are combined into the totals shown in Table XIII are all of such a nature that they could be well administered by local authorities. The great bulk of the revenue produced would be obtained in the cities, especially the larger ones, and it is these local units that are in greatest need of supplemental revenues. The activities from which these taxes are produced are, of necessity, located principally in the cities. The local rates to be imposed would be a matter for state or local determination, as the case might be. The public is fairly well conditioned to the present federal rates, and the local units could justify the use of rates at or near the present federal levies.

As a specific illustration of the gain to local revenue, the amounts of admissions taxes collected in New York State, by collection districts, in 1949, are given in Table XIV.

TABLE XIV

ADMISSIONS TAX COLLECTIONS IN NEW YORK, 1949,
BY COLLECTION DISTRICTS
(Thousands)

Internal Revenue Collection Districts in New York	Description of Districts	Admissions Tax Collec- tions, 1948
First district	Manhattan, South of 23rd St.	\$ 9,699
Second district	Kings, Nassau, Queens, Suffolk	1,924
Third district	Manhattan, North of 23rd St.	66,612
Fourteenth district	Albany Area	9,103
Twenty-first district	Syracuse Area	3,004
Twenty-eighth district	Buffalo Area	5,703
Total Admissions Tax		\$96,045

The purpose in comparing the total yield of this group of taxes, by states, with the apportionments under the pending education aid bill is to show how simply the arguments that have been advanced for the federal grant can be disposed of, in three-fourths of the states, by a revenue adjustment of this sort. That is, no foundation is left for the contention that this proportion of the states must have their trifling shares of the federal grant, in face of the evidence that here is a series of taxes thoroughly adaptable to local administration, from which far more could be obtained for local schools or other local needs, than would be supplied by the federal government.

It is clear that the taxes which are here recommended for local use are all well within the competence of local administration. All of the classes of objects are definitely located within some municipal jurisdiction, and are directly related to some aspect of community life. This point has been well expressed elsewhere:¹

The admissions tax is essentially local in character as far as incidence and administration are concerned, and it meets a number of the important requirements for an independent local tax source. First, it would enable localities to tap their own resources. The movie house is part and parcel of local economic activity. Second, it would cover most of the citizenry. Everybody sees the movies; it's a home town pleasure and privilege. Third, it is easily administered, enforced, and collected, with a minimum of inconvenience and red tape to the taxpayer. Fourth, it cannot be seriously attacked, like a sales tax on food, on grounds of being regressive, because the tax is not imposed on a commodity essential to basic living; choice also can be exercised in paying the tax because, after all, it is not compulsory to see the show.

¹ Cf. Jo Bingham, "Home Revenue for Home Rule," *The Tax Review*, January, 1948, published by The Tax Foundation.

Similar arguments can be advanced in support of local use of the other taxes in this group — leases of safety boxes, coin devices, club initiation fees and dues, bowling alleys and billiard tables, and stamp taxes on documents. In each case, the thing or activity to be taxed is definitely within some particular local jurisdiction, and local tax administrators are entirely competent to verify the returns. The documentary stamp taxes fall into two general classes, one being the transfer of stocks, bonds, and other securities on the organized exchanges, and the other including the recording of legal instruments, mainly deeds and mortgages of real property. The cities in which the exchanges are located can collect the stamp taxes on security transfers, while the counties, which are usually the jurisdictions having custody of real estate records, can collect this part of the stamp taxes.

In order to give the full fiscal benefit of these taxes to the local units it is desirable that the states now levying such taxes should withdraw, along with the federal government, as other tax resources are made available to them. The number now using admissions tax for state purposes is about twenty, but the rates are usually quite low and the present state revenue is unimportant. Even if state administration of these taxes should be retained, distribution of the receipts to the municipalities, on the basis of collections, would be logical and proper.

* * * *

Conclusions:

1. A pressing need of the day is to make greater tax resources available to the cities and towns.
2. Admissions, amusement, and like taxes are peculiarly adapted to local use, are within the competence of local administration, and would provide the localities with more revenues from their own resources.
3. By their nature, amusement and admission taxes would fall largely on urban areas — the very spots in greatest need of supplemental revenues. As an example of their effect on large city finances: in 1949 New York City provided the

federal government with nearly \$100 million in admissions taxes.

4. Exclusive local use of these taxes would increase home revenue and enhance home rule. For example, their yield could on the whole obviate the case now being made for federal aid to education: federal revenue from these taxes was \$568 million in 1949; the grants proposed for federal aid to education amount to \$300 million.

Recommendation:

1. The federal and state governments should withdraw from this field of taxing admissions, amusements, etc., and leave it to the exclusive use of the localities.

CHAPTER 6

THE FRAMEWORK OF GOVERNMENT

In this chapter and the four which follow, attention will be given to the problem of how and where to make reductions in the scope and cost of the federal government. A major thesis upon which the general program for re-allocation of resources and services between federal and state governments is based is that the federal government has become too large to be efficiently managed, too costly to be paid for without serious impairment of the national economy, and too great a threat to free institutions, by reason of its ever-expanding control, to be continued without restraint. The solution that is offered and advocated in the program developed here is a curtailment of federal responsibilities and costs by: a) the elimination of some activities; b) the return of certain service responsibilities to the states; and c) the release of tax resources to the states sufficient to permit them to assume the services returned to them.

It is clear that the costs arising out of past wars, such as veterans' care and the public debt, and also the provision of military security against future threats to world peace, will always be functions of the federal government. It is in the area of nonwar costs, or the civil services and functions, that differences of opinion and sharp conflicts of interest are encountered with respect to the matters which can properly be defined as federal, rather than state and local, functions and responsibilities. However, these conflicts are likely to be less serious in the field of the framework of government than in other fields of federal activity.

The term "Framework of Government" is used here to include the agencies and services which are essential to the organization and operation of government as such, apart from any regulatory, promotional, or welfare activities that may be undertaken. Services

of these latter types are not basic to the existence of stable and orderly government, and they were not present, or they were definitely of minor importance, during the first century of the national existence. On the other hand, it is indispensable that there be provision for such civil functions as legislative, judicial, and executive services; the conduct of foreign affairs; the enforcement of laws; the collection of revenues; the control and audit of accounts; the management of personnel; and the custody and administration of public buildings.

The deficiencies of organization in the executive branch of the government as a whole have been reviewed and catalogued in the series of reports issued by The Commission on Organization of the Executive Branch of the Government, popularly known as the Hoover Commission. Recognition of the Commission's recommendations is given at appropriate points.

It must be frankly admitted and directly faced that any program of either reorganization or curtailment of government agencies and services is difficult, even painful, of accomplishment. There are powerful vested interests among both the public employees and the beneficiaries of the public services. The line of least resistance is to tolerate bad organization and to undertake to cope with it by further multiplication of inefficient devices; and the present accumulation of defective, costly practices and procedures has been produced by this characteristic attitude of complaisance. There is no way by which the size, power, and cost of the federal government can be brought back to more nearly manageable proportions than to deal directly and specifically with the problem of multiple, badly organized, and unnecessary federal agencies.

The Framework of the Federal Government.

In accordance with the foregoing statement of definitions and concepts there is presented in Table XV a list of the various agencies which fall into the general framework category, together with recent expenditure and appropriation data from the record, and a recommendation as to the estimated necessary cost of each agency. Discussion of the basis for the amounts proposed for the support of each agency follows the table.

TABLE XV

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS
FOR THE AGENCIES CONSTITUTING THE
FRAMEWORK OF GOVERNMENT
(Thousands)

Agency	Actual Expenditures		Appropriation,	Proposed,
	1948	1949	1950	195X
Legislative	\$ 43,126	\$46,506	\$62,262	\$60,000
Judiciary	19,674	21,048	20,734	20,000
Executive Office of the President	6,076	5,507	6,385	6,640
Department of Justice	117,999	125,591	132,663	125,000
Department of State	190,937	242,024	263,119	126,000
Treasury Department	388,017	402,944	361,960	297,350
General Accounting Office	33,984	35,162	35,070	32,000
General Services Administration	—	96,872	92,617	90,000
Public Buildings Administration	71,771	—	—	—
Civil Service Commission	14,146	16,333	16,000	13,000
Tax Court of the United States	743	763	800	700
District of Columbia (U. S. share)	12,000	12,000	12,000	12,000
Miscellaneous	2,651	3,084	14,176	3,000
Sub-totals	\$ 901,124	\$1,007,834	\$1,017,786	\$ 785,690
Post Office (net)	307,011	533,595	572,777 ^a	—
Interest on nonwar debt	674,421	695,599	744,250 ^b	631,250
Grand totals	\$1,882,556	\$2,237,028	\$2,334,813	\$1,416,940

a. Budget estimate, not an appropriation.

b. An apportionment of the total, not an appropriation.

The following general explanations apply to all agencies in all years. First, the figures given above are those which relate to the cost of performing the more direct and significant functions commonly associated with the several agencies. Second, the numerous cases of payments for foreign aid, war activities and other extraneous services have been segregated and the amounts shown in the budget reports as having been charged to the above agencies have been transferred to the other proper categories. With respect to the details of the recommended future expenditure, it is necessary to comment only on those agencies for which the amounts recommended are materially out of line with the recent trend.

Executive Office of the President.

The Hoover Commission report entitled "The Executive Office

of the President" contains recommendations to provide the President with better staff services and more ample staff assistance. The following detailed recommendations are framed in accordance with these proposals.

TABLE XVI
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS, THE EXECUTIVE OFFICE OF THE PRESIDENT.
(Thousands)

Service	Actual Expenditures		Appropriation,	Proposed,
	1948	1949	1950	195X
Salary and expense allowance of the President	\$ 75	\$ 108	\$ 150	\$ 150
White House Office	1,411	1,163	1,375	1,350
Executive Mansion	445	240	260	300
Bureau of the Budget	3,334	3,261	3,300	4,000
Council of Economic Advisers	311	319	300	300
Office for Emergency Management	1,937	293	250	—
Office of Government Reports	209	23	—	—
Emergency fund for the President	500	200	1,000	500
Staff Secretary	—	—	—	20
Director of Personnel	—	—	—	20
Totals	\$8,222	\$5,507	\$6,635	\$6,640

The Hoover report proposes two additions to the existing staff. These are: 1) a staff secretary, who should be a career man with no rank or status that would authorize him to advise the President on matters of policy. Rather, his function would be to keep the President informed by providing summaries of the principal issues to be dealt with and of the staff work available on problems that have been assigned to his advisers, his staff agencies, or the heads of departments and agencies; 2) an office of personnel, the director of which should be the Chairman of the Civil Service Commission. His function would be to serve as the principal staff adviser on matters related to the career civilian service.

No position is taken here on the Hoover recommendation that the Council of Economic Advisers be replaced by a single adviser. The argument is that a single administrator can always function better than a board. This is pertinent when the duties are primarily administrative in character. However, while the direction of the research which must be done by the council's staff involves certain

administrative duties, the primary function of the council would appear to be that of giving advice based on a careful, objective interpretation of the ever shifting economic situation. It is possible that the pooled judgments of a small council, or even the majority and minority views of coordinate counselors, would be more useful and more accurate than the opinions and dicta of one person.

The allowance for the Budget Office is above the appropriation for 1950 (that figure was \$3,300,000). The Hoover Commission has recommended an enlargement of this office in order to provide assistance to the President in preparing general reorganization plans, and to function more effectively as a continuing staff agency in surveying and reviewing the current operations of departments and agencies. A similar recommendation had been made ten years earlier by The Brookings Institution.

Department of Justice.

This department was not included in the survey made by the Hoover Commission. It is assumed that many of the suggestions and recommendations of a general nature, such as those relating to improved internal departmental organization, handling of records and purchases, and others, are as applicable here as elsewhere and that every effort will be made to give effect to them. The amount proposed for the Department of Justice in Table XV is derived from official budget estimates. It includes, in addition to the Attorney General's office, the Federal Bureau of Investigation, the Immigration and Naturalization Service, and the federal prison system.

The Hoover Commission proposes to transfer the Bureau of Narcotics from the Treasury to the Department of Justice, on the ground that the principal activity of this Bureau is law enforcement rather than revenue collection. Hence its relationship with state and local police is akin to that maintained by other law enforcement agencies in the Department of Justice. The amount involved is about \$1.5 million, which can be absorbed within the overall total proposed for this Department.

Department of State.

Both the task force report and that of the Hoover Commission itself on Foreign Affairs deal at length with the great extent to

which the conduct of foreign affairs now involves governmental agencies other than the State Department. It is said that 46 out of 59 departments, agencies, commissions, boards, and interdepartmental councils under the President are involved in some aspect of foreign affairs. In June, 1948, these other departments and agencies were employing 89 percent of the 128,500 civilian employees (citizens and aliens) stationed overseas.

Large and important problems are involved in securing an effective coordination of all these operations and activities, and in correcting the structural defects found by the Hoover Commission to exist within the State Department itself. These results are outside the present purpose, although they have their bearing on it, for the fruits of more efficient operation can and should be in lower costs. In Table XVII the appropriations for 1950 are set out, together with the recommendation made here, which is largely justified by the comments of the House Committee on Appropriations.

TABLE XVII
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS,
FOR THE DEPARTMENT OF STATE
(Thousands)

Service	Actual Expenditures		Appropriation, 1950	Proposed, 195X
	1948	1949		
Salaries and expenses	\$ 97,529	\$ 84,002	\$ 77,802	\$ 75,000
Buildings fund	26,000	21,686	13,000	—
Emergencies (including contingencies)	33,544	11,744	14,700	9,000
International organizations and commissions	28,779	104,477	99,664	25,000
International, informational and educational activities	805	14,894	38,752	15,000
Philippine rehabilitation	1,899	1,106	17,166	—
International Boundary Commission (includes Rio Grande flood control)	2,379	4,115	2,035	2,000
Totals	\$190,937	\$242,024	\$263,119	\$126,000

The following comments are based principally upon the report of the House subcommittee which formulated the first version of the appropriation bill for 1950.

Salaries and Expenses. Upon recommendation of the House Committee, the Appropriation Act for 1950 (P.L. 179) lumped together salaries for domestic and foreign service. This was done to permit shifting of personnel from home to overseas, and back. The committee said that considerable savings would result.

Buildings Fund. The budget request for 1950 was reduced from \$35 million to \$13 million, on the ground that there should be more cautious appraisal of the relative advantages of owning or leasing quarters abroad. Ownership was frowned upon except where a clear case for savings could be made. It would seem that in time there should be an end to the expenditure for buildings abroad, in view of the sums that have already been devoted to this purpose.

Emergencies and Contingencies. The House Committee stated that the principal emergency is that of defraying the cost of returning stranded nationals to their home country. There should be a greater effort made than is anywhere indicated to recover part or all of this cost after the citizen has been brought into touch again with his job, his bank account, or his family. The appropriation act indicates that "contingencies" are necessary expenses which may arise in the conduct of foreign affairs for which no specific appropriations have been provided.

The Appropriation Act of 1950 carries an item of \$2,187,000 for foreign service retirement and disability which is grouped in this study with other similar expenditures for social and economic welfare (Chapter 9).

International Organizations and Commissions. The House Committee suggested that there are too many international organizations, and that elimination of some, and consolidation of others, would be in order. This is excellent advice and should be followed. The largest item in the 1950 appropriation is \$70 million for the International Refugee Organization, which the Committee said would be liquidated by the end of next fiscal year.

Philippine Rehabilitation. The projected estimate assumes that there will be no need for an indefinite prolongation of the support of the Philippine Republic.

International Boundary Commission. This Commission discharges certain obligations incurred under various treaties with Mexico, including, among other things, operation and maintenance of the Rio Grande rectification, canalization, flood control, bank protection, boundary fence, and sanitation projects.

Treasury Department, General Accounting Office, and Office of General Administration.

In view of various recommendations of the Hoover Commission, it is desirable to consider together the Treasury Department, the General Accounting Office, and the newly created Office of General Administration. This Commission recommended transfer of the Bureau of Federal Supply from the Treasury to the proposed Office of General Services, and the creation in the Treasury of a new position, Accountant General, to assume certain responsibilities for government accounting not now clearly vested in the General Accounting Office.

In addition, the Commission recommended transfer of the Coast Guard from Treasury to Commerce, and the extension of Treasury jurisdiction to cover Reconstruction Finance Corporation, Federal Deposit Insurance Corporation, and the Export-Import Bank. Further study was suggested of the possibility of transferring to Commerce certain marine functions of the Bureau of Customs. Mention has already been made of the recommendation to transfer the Bureau of Narcotics from the Treasury to the Department of Justice.

It is beyond the purpose of this discussion to pass judgment upon all of these reorganization proposals. Some of them evoked vigorous dissenting views from members of the Commission. The principal concern here is with the problem of reducing the scope and the cost of federal operations. All who are interested in these objectives should approve any reasonable plan for achieving them. Too frequently, however, the Hoover Commission goes no farther in support of its recommendations than to say that the savings would be considerable. It is necessary to be more specific, and such is the intent of the following discussion, which begins with the Treasury Department. The details of this departmental budget are given in Table XVIII.

TABLE XVIII

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE TREASURY DEPARTMENT

(Thousands)

Service	Actual Expenditures		Appropriation	Proposed,
	1948	1949	1950	195X
<i>General Administration:</i>				
Office of the Secretary ^a	\$ 9,321	\$ 2,320	\$ 2,985	\$ 800
Division of Tax Research	209	126	135	125
Office of General Counsel	316	267	400	325
Office of Administrative Services	1,332	1,419	1,150	1,300
Sub-total, General Administration	\$ 11,178	\$ 4,132	\$ 4,670	\$ 2,250
<i>Fiscal Service:</i>				
Bureau of Accounts ^b	\$ 82,099	\$ 56,678	\$ 12,650	\$ 12,000
Bureau of Public Debt	53,435	54,004	53,450	50,000
Office of Treasurer	5,117	5,301	5,900	5,000
Bureau of Customs ^c	31,849	52,642	35,450	33,000
Bureau of Internal Revenue	184,731	207,513	226,300	175,000
Bureau of Engraving and Printing	11,626	15,453	15,660	12,000
Secret Service	2,941	2,976	3,082	3,000
Bureau of the Mint	5,041	4,245	4,800	4,800
Sub-total, Fiscal Service	\$376,839	\$398,812	\$357,292	\$294,800
Total, Treasury Department ^d	\$388,017	\$402,944	\$361,962	\$297,350

- a. In 1948 and 1949, the Secretary's office was charged with penalty mail costs. Under the present procedure, these bookkeeping operations no longer appear in the departmental accounts. Through the years 1948-1950, there is also an item, "Refunds under Renegotiation Act." In the final estimate of need this item is dropped on the assumption that such refunds will not continue indefinitely. Another item, "Interest on deposits of Philippine public moneys" is excluded throughout. Although authorized as a permanent, indefinite appropriation, this practice should be discontinued promptly.
- b. In 1948 and 1949 the Bureau of Accounts paid substantial amounts under the heading, "certified claims over \$500." No appropriation for this purpose appears in the House Bill for 1950 and no provision is made for it in the final estimate.
- c. The refunds of customs duties are excluded from the Bureau of Customs totals, in accordance with the present policy of deducting all tax refunds from receipts.
- d. The grand totals exclude the expenditures for interest on the debt, foreign aid, refunds, Bureau of Federal Supply, and the Coast Guard. See the text discussion below.

Aside from the exceptions indicated in the notes to Table XVIII, the principal departure from the recent pattern of Treasury Department expenditures is in the suggested allowance for the Bureau of Internal Revenue. The reason for this is that the cost

of administering the taxes which are allocated for federal use in the overall program can be and should be materially less than the cost of the present federal tax system. The Hoover Commission recommended a consolidation of Customs and Internal Revenue, but offered no estimate of the resultant savings in administrative cost.

This Commission's recommendation for the establishment of a new office of Accountant General in the Treasury Department was the subject of vigorous dissent from several members. Beyond question there is vast room for the improvement of federal accounting systems and procedures. That such is the case is a highly significant and revealing comment on the indifference to economy and efficiency that has long characterized the federal administration. The controversy involves the means rather than the end. Joint action by the Treasury, the Budget Bureau, and the General Accounting Office has recently been inaugurated and will no doubt be given impetus by the Hoover Commission's report, regardless of the final disposition of the jurisdictional issues that have been raised. No position on this matter is taken here. Accordingly, no change has been made by way of incorporating the proposed new office or modifying the present status and appropriation of the Treasury Bureau of Accounts. No data are given by the Hoover Commission as to the necessary rearrangement of appropriation items to implement its recommendations on these points.

The Hoover Commission's task force report on the Post Office recommended that responsibility for pre-audit and preliminary settlement of postmasters' accounts be transferred from the General Accounting Office to the Post Office Department, thereby limiting the function of the former agency to the final audit. It is said that this would eliminate the bulky and tedious correspondence between 42,000 postmasters and the General Accounting Office and make possible the virtual dissolution of the postal accounts division of that office. It also recommended that recruitment of personnel be transferred from the Civil Service Commission to the Post Office, within the framework of rules laid down by the Commission. Total net savings from these changes were estimated at \$2 million. In Table XV it is assumed that this

amount would be divided equally between the General Accounting Office and the Civil Service Commission.

General Services Administration.

Among the most valuable and constructive of the Hoover Commission studies are those dealing with certain internal activities, namely, supply, records, and the management of public buildings. It was proposed that these services, which at some points suffer from lack of direction and at others from too much control, be assembled in a new "Office of General Services," under a director who is to be directly responsible to the President. An act of 1949 (P.L. 152) embodied some of these recommendations in the creation of an agency known as General Services Administration. The case made for this aspect of the reorganization program is strong and persuasive, as the following representative data illustrative of the present situation clearly show:

Supply. Federal purchases of supplies and equipment for all purposes now run well over \$6 billion annually and the trend is still upward. This is the second largest avenue of expense in the budget, being exceeded only by personal services. The total inventory of supplies in all government storage points in the United States, military and civilian, is said to be approximately \$27 billion. Some agencies are said to have supplies enough on hand to last them for fifty years. Incomplete data indicate that a total of 147,868 employees in civil and military agencies are occupied with supply, at an annual salary cost of at least \$443,604,000. An analysis of 600,000 purchase orders issued by 19 civilian agencies revealed that 90 percent of the orders represented only 10 percent of the dollar volume. This and other analyses led to an estimate that some 3,000,000 purchase orders were issued every year by all federal buying offices and that approximately one-half averaged less than \$10. Even the partial cost of processing a purchase order was said to be greatly in excess of \$10.¹

These data emphasize the importance of orderly, systematic procedures for the purchase, storage, and disposition of supplies

¹ Task Force Report on *The Federal Supply System*, p. 39.

and equipment and suggest the immense opportunities of saving that are in prospect from an improvement of the present situation. The task force report to the Hoover Commission on the federal supply system is emphatic in asserting that introduction of the recommended Central Supply Service would result in savings materially in excess of 10 percent in purchases, personnel, storage space, and shipping costs. Even on the basis of this conservative percentage, the savings on annual purchases and personnel costs alone would aggregate at least \$650 million. Taking the other aspects of the whole supply problem into account, the total savings could rise toward \$1 billion. These savings are not precisely allocable to the various departments and agencies on the basis of available data. Since the military establishment has far the largest part of the total inventory, a proportionate share of the saving would naturally be realized in that area.

Transportation. The task force report cited above states that the federal government spends more than \$1 billion annually for the transportation of property. This excessive cost results from the lack of adequate provision for protecting the government's interest in transportation charges. Freight rate classifications and schedules are devised for private commercial shipments. The Interstate Commerce Act authorizes special quotations for government, and also changes in carriers' tariffs. It is necessary, however, that there be in the government service traffic experts who can make the studies which would reveal the opportunities for such action. Without this foundation knowledge of how and where to save, government shipments are likely to move at high rates.

The task force estimates that an adequate traffic unit could be set up in the Office of General Services for a cost of \$3.5 million to \$4 million. In view of the amount now involved in transportation costs, this would appear to afford an opportunity for substantial savings.

Records. The Hoover Commission's task force report on Records Management estimates that the annual cost of record-making and record-keeping is \$1.2 billion. The volume of records now existing is estimated at 18,500,000 cubic feet. It is obvious that an aggressive attack should be made on this problem, and also

that there is an opportunity for large savings, in view of the immense cost involved.

No estimate of the cost of the proposed central records administration is presented, but it is said that the cost of the central staff organization would be negligible.² The function of this central staff unit would be that of programming and supervising the operations involved in screening records, transferring them to record centers, delivery to the National Archives of papers and documents of permanent historical interest, and destroying duplicate and obsolete records. The essential attack is to be made through the departments and agencies, acting under instructions and procedures to be developed by the central staff.

Public Buildings. The Hoover Commission recommends that the activities involved in the maintenance of public buildings, allotment of space, and moving service in the District of Columbia and some selected cities be placed under the proposed Office of General Services. The military establishment and the Post Office would be excluded, although cooperative arrangement should be established with these agencies.

The complete design of the Hoover Commission was not incorporated in the reorganization effected by the Act of 1949. This act brought together under the General Services Administration the Public Buildings Service, The Federal Supply Services, and the National Archives and Records Service, all of which had been mentioned in the Hoover recommendations. The transportation service was not included, however. An agency not considered by the Hoover Commission for inclusion, namely the Community Facilities Service, was transferred to the new agency. Under it is grouped the functions of the Federal Works Agency, and those of the Public Roads Administration.

In order to introduce the new agency into the budget pattern, the Budget for the Fiscal Year 1951 reclassified a considerable number of expenditure items for the year 1949, and likewise of appropriation items for the year 1950, as if they had been made by, or for, the General Services Administration, although it was not then in existence. The amounts shown for these years in Table XV above represent the figures relating to public buildings,

² Task Force Report on *Records Management*, p. 21.

in so far as such items could be identified. The other expenditure purposes for which amounts were assigned to this agency have been grouped elsewhere, to accord with the tabulation practice which had already been established before the recent budget data were available.

The principal function of Public Roads Administration, now re-named Bureau of Public Roads, has been to parcel out the federal highway grants. Under the program of re-allocation that is proposed here it is expected that the federal grants will largely disappear. This would leave, as the principal future activity of the Bureau the servicing of state highway activities by supplying counsel, and the results of such highway research as might be properly and profitably conducted by a federal agency.

Civil Service. Reference was made above to the Hoover Commission proposal that there be an Office of Personnel in the Executive Office of the President. This is part of a program which was developed by the Commission for the improvement of the whole personnel situation. It was estimated that the total annual salary bill of the government is now more than \$6.5 billion, a fact which warrants intensive search for improvements and economy. The details of the Commission's personnel program are not within the present purpose, but any savings which are possible should be zealously sought. In addition to the economies which may be realizable from the reforms proposed, and the Commission asserts that these are large, a further source of reduced cost which is not stressed is a reduction of the number of federal employees. Commissioner Pollock, in a supplemental statement, pointed out that neither the task force nor the Commission treated the serious problem of overstaffing at all.

The Post Office (Net Deficit).

In one respect the postal service may be regarded as part of the essential framework of government. This most essential aspect involves the safe transportation and delivery of private communications among the citizens, and between the government and the citizens. In other words, the first class mail service, which was the original postal service and for many years the only one, has long been recognized here and elsewhere as a direct responsibility of

government. The Constitution delegates this responsibility to the federal government.

In many directions, however, the postal service has been broadened to include activities which are essentially of a business rather than a strictly governmental nature. In their conduct there is direct competition with private business. Examples are the postal savings system, the parcel post, the transfer of funds by postal money order, and the insurance of merchandise in transit. From the point of view of these services, the postal system is essentially a form of business enterprise, operated both in competition with, and as a means of promoting, private economic activity. It would be appropriate, because of the dual character of the modern postal service, to classify it either as part of the essential framework of government or as an agency designed to promote and regulate private business and economic activities.

Regardless of classification, the only aspect of the postal service that is of direct concern here is the size of the postal deficit, the reasons therefore, and the steps that may be taken to reduce or eliminate it. The causes of the deficit and the remedial action to be taken, are dealt with at length in the Hoover Commission's task force report on the Post Office. This discussion is too lengthy and too detailed to be reproduced, or even summarized adequately here. The findings are significant. The task force report states³ that net savings of more than \$80,000,000 annually can be effected in the post offices having receipts of over \$1,000,000 a year if operations are placed under better management control. The gross savings are estimated at \$90,000,000 at least, and in order to realize this gain an annual expenditure of some \$8,000,000 would be required. In addition, further annual savings of at least \$60,000,000 are said to be possible from improvements in methods and equipment requiring extensive development or major capital expenditures. Included in the improvements proposed are changes recommended with respect to auditing and personnel selection which would produce savings of at least \$2,000,000 annually in the cost of the General Accounting Office and the Civil Service Commission. Hence, in last analysis, the task force report points out, implementation of its proposed program would require additional

³ *Op. cit.*, p. 66.

annual expenditure of about \$6,000,000. The peak of this additional expense would probably not be reached in less than three years, and the full savings to be realized would not be achieved until the program is in full operation.

Approaching the subject from another direction, that of revised postal rates, the House Committee in charge of the Post Office appropriation bill for 1950 cites an estimate by the Postmaster General that enactment of a pending bill (H. R. 2945) would increase postal revenues by \$250 million. The deficit presently anticipated for 1950 is \$403 million, and the appropriations subcommittee points out that the proposed rate revisions would reduce that amount to \$153 million, and states, further, that this remainder is approximately the amount required to cover the cost of official penalty mail, franked mail, airline subsidies, and other costs not properly chargeable to the users of the postal service.

The sum of these two approaches, namely improved management and postal rate revision, is that when both are finally and fully operative, the postal deficit could be almost, if not completely eliminated. In the estimate and recommendation presented in Table XV, it is assumed that both sets of proposals referred to above will be accepted and put into effect.

Interest on Nonwar Debt.

The total amount paid as interest on the public debt, as reported in the budgets, has been distributed between the nonwar debt and the war-connected debt. The formula for making this distribution was developed by assigning to the nonwar category the outstanding total in 1914 and the increase of debt from 1930 to 1940. This nonwar debt, subtracted from the total outstanding in February, 1946, gave the war-connected debt. The proportions were, 13 per cent nonwar, and 87 per cent war-connected. These proportions have been retained notwithstanding some decline of the debt from its 1946 maximum, since the contribution of greater accuracy from laborious calculation of the original purpose of the issues actually redeemed was not worth the effort.

* * * *

Conclusions:

1. Limiting federal functions and services to those of genuine

national concern and responsibility will reduce the federal organization to a scope which can be properly managed by the President.

2. With the federal government operating in its own proper sphere, the full benefit of the Hoover Commission recommendations can be obtained, and the large savings indicated by that Commission will be of even greater significance.
3. This program's proposals regarding the framework of government alone, will permit expenditures for those functions to be reduced from the 1949 level of \$1,883 million to some \$1,417 million in 195X.

Recommendations:

1. The Office of the President should include a Staff Secretary and an Office of Personnel.
2. The Department of State.
 - a) Real effort should be made to end expenditure for buildings in foreign countries;
 - b) Recovery should be made of all, or at least more than at present, of the costs of returning stranded nationals;
 - c) There should be an elimination of some and a consolidation of other international organizations;
 - d) Salaries for domestic and foreign service should be lumped together to permit shifting of personnel;
 - e) Support of the Philippine Republic should not be prolonged indefinitely.
3. The Treasury.
 - a) The Bureau of Narcotics should be transferred to the Department of Justice;
 - b) Appropriations for interest on deposits of Philippine public monies should be discontinued promptly;
 - c) The cost of administering taxes should be reduced in accordance with the general tax re-allocation here proposed.
4. The postal deficit should be substantially if not wholly eliminated through improved management, audit and personnel control, and by revision of the postal rates.

CHAPTER 7

THE PROMOTION AND SUPERVISION OF BUSINESS AND ECONOMIC ACTIVITIES

In passing from the relatively non-controversial field of the essential framework of government into other areas of big government, sharp conflict of interests and opinions is encountered. In a certain respect, the public services in these areas are optional rather than basic. That is, there is room for wide variation of decision as to the scope of the services performed, the degree of thoroughness or extent of coverage in each case, and also as to whether the subject is one properly falling within the domain of the federal or the state governments, respectively.

The principal sources of federal authority to engage in the regulation, supervision, and control of business activity are found in the constitutional provisions relating to the postal power and the power to regulate interstate and foreign commerce. In recent years there has been an increasing disposition to interpret the general welfare clause broadly, as conferring upon the federal government authority to engage in virtually any and every kind of activity under the guise of promoting the general welfare. The courts have been liberal in their construction of the breadth and scope of these powers, and thus have been an important factor in their expansion. It is very odd, however, that the men who wrote the Constitution should have taken the trouble to enumerate the federal powers if their intention had been to grant the power to do anything or everything under a blanket general welfare provision.

The regulatory and supervisory activities of the federal government have been so greatly expanded, and in so many different directions, that no simple classification of the agencies which exercise these functions is possible. There are brought together here those agencies which are concerned with regulation and supervision as a primary activity, even if, in some cases, they have been given

other responsibilities. It is recognized, also, that other departments, such as Agriculture, Interior, and Labor, exercise various kinds of supervision and control, but not as their principal reason for existence.

There is presented, in Table XIX, an overall summary of the expenditures, appropriations, and recommendations for the agencies which are grouped together here under the promotional and regulatory function. In subsequent tables and discussion the supporting details are set forth.

TABLE XIX

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR AGENCIES PRIMARILY CONCERNED WITH THE PROMOTION AND SUPERVISION OF BUSINESS AND ECONOMIC ACTIVITIES
(Thousands)

Agency	Actual Expenditures		Appropriation Proposed,	
	1948	1949	1950	195X
Department of Commerce	\$ 172,875	\$ 235,862	\$ 259,271	\$181,200
Coast Guard	110,228	132,064	145,684	100,000
U. S. Maritime Commission	291,678	133,308	84,970 ^a	75,000
Public Roads Administration	337,195	425,898	409,179	50,000
Nat'l Advisory Committee for Aeronautics	37,543	48,683	53,000 ^b	40,000
War Assets Administration	286,702	86,945	^c	
Federal Communications Comm.	6,137	6,621	6,600	6,000
Federal Power Commission	3,763	4,236	3,700	3,800
Federal Trade Commission	2,960	3,492	3,650	3,000
Interstate Commerce Comm.	10,529	11,250	11,234	11,000
Securities & Exchange Comm.	5,532	6,083	5,750	5,500
Tariff Comm.	1,141	1,260	1,238	1,200
Panama Canal (incl. Panama R.R.)	18,360	24,731	22,065	22,000
Alaska Communications System	1,301	1,973	3,000	2,500
Totals	\$1,485,423	\$1,122,406	\$1,009,341	\$500,400

a. Contract authorizations additional. See Table XXII.

b. Plus contract authorization of \$10,000,000.

c. War Assets Administration functions transferred to General Services Administration.

In view of the amounts involved, it is evident that a large element of cost in the services and activities covered in Table XIX, is properly to be regarded as promotional rather than regulatory. In fact, the cost of the obviously regulatory commissions and

agencies is only a very small part of the total. The promotional activity includes, in several instances, substantial amounts of grants and subsidies.

The Hoover Commission has published a task force report on Regulatory Commissions. The main emphasis of this report was upon the proper principles of organization and administration for bodies of the regulatory sort, and upon a segregation of the quasi-judicial function of regulation from operating or other executive activities and services. At the appropriate places in the following discussion, references will be made to some of the recommendations which point toward such a separation of functions.

The Department of Commerce. In Table XX there is presented the expenditure and appropriation record of the Department of Commerce.

TABLE XX
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE DEPARTMENT OF COMMERCE
(Thousands)

Division	Actual Expenditures		Appropriation Proposed,	
	1948	1949	1950	195X
Secretary's Office	\$ 5,264	\$ 4,522	\$ 1,518	\$ 1,200
Census Bureau	9,451	13,666	48,610	15,000
Civil Aeronautics Administration	100,784	147,292	139,249 ^a	100,000
Civil Aeronautics Board	2,982	3,615	3,621	3,500
Coast and Geodetic Survey	9,809	10,304	10,960	10,000
Bureau of For. & Dom. Commerce	8,254	10,175	11,509	9,000
Patent Office	8,674	9,930	10,825	10,000
National Bur. of Standards	5,459	9,580	8,800	8,500
Weather Bureau	24,238	24,298	24,179	24,000
Miscellaneous	195	2,000		
Totals	\$172,875	\$235,862	\$259,271	\$181,200

a. In addition, contract authorization of \$67,300,000.

The expenditure for the office of the Secretary of Commerce includes an item for the Office of Technical Services, the amount appropriated for which in 1950 is \$219,000. In the report of the House subcommittee on the 1949 appropriation bill for the Department of Commerce, the following pertinent passage occurs:

The committee agreed to the continuation of this item last year with the understanding that the activity would be considered for liquidation when the bulk of the German technical data was processed. However, it

would appear from the testimony given that the Department is intending to continue the activity for the purpose of analyzing and distributing to the manufacturers of this country data developed and to be developed by the several research organizations of the Federal Government. Furthermore, while the Department is attempting to justify the continuance of this item on the basis of its broad authority to foster and promote foreign and domestic commerce, it is the feeling of the committee that when such broad legislation was enacted many years ago no such activity was contemplated and consequently cannot be considered as authorized at the present time. Information made available to the committee casts very serious doubts on the values to the American business which are claimed for this office. Letters received indicate that the Office of Technical and Scientific Services is performing no function which business cannot do for itself and that the information received from this office is either of little or no value or can be secured from the numerous technical and scientific publications being published privately.

There has been no effective rebuttal to this conclusion, and the discontinuance of the Office of Technical and Scientific Services is recommended. No provision is made for it in the final estimate of requirements.

The Census Bureau faces for the fiscal year 1950 and for one or two years thereafter the responsibility of making and publishing the decennial census as required by the Constitution. Periodically, the necessary expenditures for this Bureau will be much above the amount required by the routine work of the intercensal periods. The final estimate is intended to apply to the years between the peaks, and it is submitted with the recognition that the extraordinary requirements of the successive censuses must be met as they come along.

The Civil Aeronautics Administration now accounts for more than half of the total expenditure of the Department of Commerce. The Hoover Commission's task force report summarizes the principal functions of this agency as follows:¹

1. The administration and enforcement of the safety standards and regulations promulgated by the Civil Aeronautics Board in the Civil Air Regulations.
2. The development and operation of an extensive system of Federal airways within the United States.
3. The administration of the Federal Airport Act of 1946 for the construction of a Nation-wide system of civil airports by Federal aid to State and municipal governments.

In addition, the Civil Aeronautics Administration conducts research projects designed to benefit civil aviation in general.

¹ Task Force Report on *Regulatory Commissions*, p. 72.

The details of the expenditures and appropriations for CAA are given in Table XXI.

TABLE XXI
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR CIVIL AERONAUTICS ADMINISTRATION
(Thousands)

Division	Actual Expenditures		Appropriation Proposed,	
	1948	1949	1950	195X
Salaries and Expenses	\$ 61,650	\$ 86,422	\$ 94,402	
Establishment of Air				
Navigation Facilities	16,524	15,378	18,650 ^a	
Air Navigation Development		60	3,000 ^b	Not
Technical Development	1,518	1,777	1,450	Dis-
Federal-Aid Airport Program	7,757	33,215	14,500 ^c	trib-
Public Airports, Alaska		859	5,800	uted
Washington National Airport	958	2,790 ^d	1,447	
All Other	12,377	6,611 ^e		
Totals	\$100,784	\$147,292	\$139,249	\$100,000

a. Plus contract authorization of \$26,800,000.

b. Plus contract authorization of \$4,000,000.

c. Plus contract authorization of \$36,500,000.

d. Construction \$1,788,000; maintenance and operation, \$1,182,000.

e. Includes \$4,425,000 for Philippine rehabilitation.

The budget makes no segregation of the cost of administering and enforcing the safety standards and regulations promulgated by the Civil Aeronautics Board, which is the principal regulatory activity of CAA. It is evident that the amount appropriated for salaries and expenses includes the cost of this regulatory function and also that of constructing and operating the air navigation facilities and of distributing federal funds under the grant-in-aid program.

The Civil Aeronautics Administration came into existence under Reorganization Plans III and IV, effective June 30, 1940. It is significant that in 1948, after eight years of operation, the services of a private management firm were considered necessary in order to discover and apply methods of greater efficiency and economy. The appropriation sub-committees of 1948 and 1949 both pointed out that the federal government is being drawn into larger and larger costs in the airport program, and in both reports there were strong suggestions that a considerable portion of the federal cost

should be made reimbursable, either by the municipalities in which the facilities are provided or by the airlines.

Some idea of the character of program that has been laid out may be had from a statement by the Director of Airports to the House committee in hearings on the 1950 appropriation. This statement was that there were 2,090 existing public airports in need of additional improvements, and 2,745 new locations where new construction or development of an existing airport is pending, a total of 4,835 airports. Since there are only about 3,000 counties in the United States, this is a nation-wide average of more than one and one-half airports per county. The total estimated cost of this development was said to be \$1,048,500,000, of which the federal share would be \$469,700,000.¹ The House appropriations sub-committee in 1949 touched upon this situation in the following language:

The committee wishes to call to the attention of the Administrator its apprehension regarding the future utility of the airport pattern being established. Instances have been called to the attention of the committee wherein approval for a certain class of airport has been given despite the fact that a similar or nearly similar class airport existed in the immediate vicinity.

It may be conceded that in the early stages of modern air travel, as in the early stages of modern highway travel, the mechanical improvements in transportation equipment came too rapidly to be met by the absorptive processes of private and/or local action in the provision of facilities essential to the operation of the new mechanisms. There has been, in fact, a large expenditure of federal funds, in part as grants and in part as subsidies, toward the furnishing of these facilities. The important problem for the future is — When can the burden of these costs upon the federal government be terminated, or greatly reduced? There is no thought here that a time may come when no further public expenditure will be required. Rather, the question involves the attainment of a sufficient degree of development such that the users and the local, or state-local units of government, can take over the job of maintenance, together with such gradual expansion of facilities as may be required. As one example, maintenance and operation of the Washington National Airport costs the government more than

\$1 million annually. This should be a charge against the users of the service, not against federal taxpayers generally.

The solution of this problem depends, in part, upon re-allocating to the states and cities revenue resources sufficient to enable them to take over that part of the task which is essentially related to civil aviation. There will always be present in the aviation situation a certain element of national defense, and hence some portion of the costs would be properly chargeable to the defense budgets. The House appropriations sub-committee on the 1950 bill pressed the Administrator for some indication of a possible apportionment of present costs for air navigation development between the defense services and CAA, and the existence of some duplication of expenditures was admitted.² That is, it was admitted that both the Navy and CAA were spending money for the same things. The amount of duplication involved was not stated.

The principal sources of large future federal expenditure in the civil aviation field are:

1. Grants to aid municipalities in the acquisition of sites and in the construction of airport facilities. The federal shares are: a) for acquisition of land, 25 percent; b) for construction of runways and administration buildings, 50 percent. No federal contribution is made toward the construction of hangars. It was noted above that the present estimate of the federal share of the program of improvement and new airport developments is \$470 million. The period over which this amount would be spent was not indicated in the hearings on the 1950 bill.

2. Equipment and operation of control towers and other devices to promote greater safety in all-weather flying. The municipalities are required to build the control towers. The federal government installs, owns, and operates the equipment in them. One estimate given at the hearings was for a total federal expenditure of \$738 million over a period of years.

The avenues for reduction of the federal burden are the following:

1. A more cautious policy of designating additional federal aid airports. It is extremely doubtful if the number now in the pro-

² Cf. *Hearings on Department of Commerce Appropriation Bill for 1950*, pp. 229, ff. Unless otherwise noted, citations are to House hearings.

gram, some 4,835, can be justified on the basis of sound and necessary aviation development. Testimony in the hearings on the 1950 appropriation bill indicated that only a few municipal airports are operating "in the black." The average airport derives 65 percent of its receipts from nonaviation sources. The House committee dealing with the 1950 bill waxed sarcastic over the use of federal funds to send out counselors to advise local airport managers on the operation of coffee shops and on growing wheat and other crops on airport land.

2. Delegation of greater responsibility to state aviation commissions. More than 30 states now have such commissions. They are competent to participate in policy decisions, and should do so, particularly in such matters as local airport selection, routes, and similar matters. They have, or are able to provide, engineering and other assistance in construction operations.

3. A continuous policy of transfer to municipalities and to the private airlines of greater shares of the operational cost. Let it be granted, for the sake of argument at least, that the initial capital expenditures are a justifiable area of federal aid, when combined with judicious selection of locations, on the ground that there is an important national defense aspect in sound civil aviation development. Nevertheless, it does not follow that there should always be large federal contributions toward the current operation of airport facilities. The administrator of CAA said,³ in response to questions in the 1950 hearings, that "if the air lines can guarantee regularity of service and can insure a greater degree of safety to the traveling public than they can at the present time, it will greatly improve their financial condition."

The purpose of the large expenditure to be made by the federal government on the development of air navigation is to provide conditions and facilities that will contribute to these results. Likewise, the objective of the federal inspection of aircraft and of the civil air regulations, is to promote safety. If it be assumed that the federal expenditures will be sufficiently helpful in accomplishing these ends to warrant making them, then it should follow that the airlines and the municipalities together can eventually take over the expense of operating the air navigation control system. The

³ *Idem*, p. 166.

amount proposed in Table XX for the CAA namely \$100 million, is more than should eventually be required, once the hump of construction is passed and the improvements in air navigation are provided.

The Civil Aeronautics Board. It was noted above that the Civil Aeronautics Board is the regulatory authority that promulgates regulations for the control and supervision of civil aviation and that the CAA administers and enforces these regulations. The Board has other functions of a regulatory nature, including the following:

1. Grant certificates to domestic air carriers seeking to operate as common carriers. The Board has power to condition, amend, or suspend these certificates.

2. Issue permits to foreign air carriers seeking to engage in air transportation to or from the United States.

3. Prescribe lawful rates for air transportation, except in the case of foreign air transportation.

4. Determine the rates to be paid air carriers for transportation of mail.

5. Control mergers, interlocking relations, and carrier agreements.

6. Issue safety regulations. As an incident to the safety function, the Board is required to investigate aircraft accidents to determine their probable cause so as to prevent recurrence. In this connection it is worth repeating the following colloquy between Congressman Rooney, Chairman of the House subcommittee, and Mr. Rentzel, CAA administrator, on the possible overlap of accident investigations by the two agencies:⁴

Mr. Rooney. With regard to the field of accident investigations, is there not duplication of work between the CAA and the CAB in this regard?

Mr. Rentzel. No, sir; I do not feel that there is. There is, of course, a possibility of some overlap in the field of investigations, but we have confined our efforts to the responsibility of finding out what caused the accident.

Mr. Rooney. Isn't that exactly what CAB seeks to find out?

Mr. Rentzel. They approach it from a judicial point of view. We must, under our responsibility, investigate the accident to determine what immediate action should be taken to prevent a similar accident and what we can gain in the way of a modification.

⁴ *Idem*, p. 181.

Mr. Rooney. Is that not exactly what the CAB does when it intervenes in an accident investigation?

Mr. Rentzel. Well, it goes at it from a different point of view. We have coordinated our efforts.

Mr. Rooney. Will you please explain that different point of view?

Mr. Rentzel. The Board's responsibility is the judicial approach to a determination of the cause of the accident and its responsibility.

Mr. Rooney. Yours in effect is the same, is it not?

Mr. Rentzel. In a different way. We are looking at it purely from the administrative point of view and what action we must take to avoid a similar recurrence.

Mr. Rooney. Does not the Board look at it from an administrative point of view with the idea in mind of promulgating a regulation which would prevent the recurrence of such an accident?

The point of inquiry, from which the foregoing sample is taken, came to nothing so far as conclusions are concerned. There is evidently a duplication and probably some expenditure that could be avoided.

The CAB has the responsibility and authority to establish the payments to be made to the air carriers for carrying mail. These payments become a charge against the Post Office and eventually find their way into the net postal deficit.

The Coast Guard. The Hoover Commission recommended that the Coast Guard be transferred from Treasury to Commerce, on the ground that the greater part of its activities and operations involved services to business and commerce, rather than services in connection with the collection of the revenue. During the prohibition era the Coast Guard was active in coast patrol to prevent smuggling of liquors, but the occasion for this work is now past.

The important question for the present purpose is not where the Coast Guard is to be lodged, for administrative housekeeping purposes, but rather the cost of this service, whether it be under Commerce or Treasury Departments. In others years the Coast Guard has been criticized by appropriation committees for various reasons, notably the defective condition of its accounts and the propensity to overload the service with high ranking officers. The House report on the appropriation for 1950 refers again to the latter subject in the following words:

The committee has not attempted to specify exactly the numbers of personnel by grades that should be allowed but definitely feels that there are too many officers in the higher ranks. The justifications indicated that further increases were planned in the number of officers in the rank of

commander and above. The committee hopes that the Coast Guard will review this situation most carefully with a view to reducing the ratio of higher officers to enlisted men.

It is significant that an independent industrial management firm was retained to make a study of the Coast Guard organization and procedures. When a condition of disorganization and bad procedures has developed so far as to warrant an overhaul of this sort, the amounts appropriated and expended are in no sense a reliable guide to the proper cost of a service.

The Maritime Commission. The Hoover Commission's task force report on Regulatory Commissions proposed a separation of the operative and administrative functions from those which call for judgment and consultation. The recommendation was in line with the general philosophy of the Hoover Commission, which was that duties of an administrative or executive type should be placed in charge of a single administrator, while the duties of a quasi-judicial type should continue to be in charge of a board or commission. In the case of the Maritime Commission it was recommended that the administrative aspects be put under an administrator who should be in the Department of Commerce, or in a new Department of Transportation, in the event such a new department should be established.

For the purpose of this study, it is not necessary to take a position on the task force recommendation. There has been a considerable accumulation of evidence, in the recent hearings on the Maritime Commission appropriations, to show that the Commission has not done a first-class job of administration. The Comptroller General has complained about the Commission's accounting, and the House subcommittee emphasized again, in its report on the 1950 appropriation, the difficulty that had been encountered in forcing the Commission to clean up the tremendous backlog of work that had been piled up for years in connection with the processing of certain accounts. There is, no doubt, much validity to the Hoover Commission view that more vigorous management is required. The Commission does not, however, offer any suggestion as to the amount of savings to be realized, so far as the direct costs of the agency are concerned.

As a matter of fact, the direct housekeeping cost of the Mari-

time Commission is not the principal element in the total expenditure made under its direction or authorization. Hence, while the segregation of functions proposed by the Hoover task force could possibly result in some net reduction, the major problem would still remain. That problem is the amount of the subsidies to be authorized and paid in support of the merchant marine. Some idea of the present situation in that regard can be had from the House appropriation subcommittee's recommendation for the year 1950.

TABLE XXII
APPROPRIATIONS FOR SALARIES AND EXPENSES,
U.S. MARITIME COMMISSION, FISCAL YEAR 1950

Function	Amount
General administrative expenses	\$ 8,950,142 ^a
Ship construction and betterments	26,875,000 ^b
Maintenance of shipyard facilities	425,000
Warehouse operating expenses	480,000
Operating-differential subsidies	18,218,382
Reserve fleet expenses	7,134,800
Maintenance and operation of terminals	510,850
Reserve for claims and miscellaneous expenses	420,000
Total	\$63,014,174 ^c

- a. And \$568,648 of the unobligated balance in the Federal ship mortgage insurance fund.
b. And \$70,125,000 contract authorization; and \$104,000,000 prior funds and contract authorization continued available until September 30, 1949.
c. In addition not to exceed \$15,000,000 of prior funds for War Shipping Administration liquidation.

The two types of subsidy are illustrated in the above table. They are: 1) a construction subsidy, under which the Maritime Commission contracts for the construction of a ship which is then sold to a private operator for a percentage of the cost; 2) an operating-differential subsidy under which the Commission makes certain payments to private ship operators as an indemnification of the higher operating costs under American registry. This second form of subsidy is subject to a recapture provision, which is that if the earnings, averaged over a stated recapture period, are more than 10 percent on the capital necessarily employed in the business, the excess is divided equally between the operator and the government until the full amount of the operating-differential subsidy has been recovered. In a ten-year recapture period ending on or near to December 31, 1948, operating subsidies totalled \$63 mil-

lion, and recoveries amounted to \$46 million. This high recovery ratio was explained by the large war shipping profits earned during the years 1939 through 1942.

A decision as to the future duration and volume of the ship subsidies is, of course, vital to a projection of the cost, but such a decision involves broad issues of public policy which include national defense and a peacetime merchant marine. The testimony on the 1950 appropriation brought out the fact that there are now 1,188 oceangoing ships of 1,000 gross tons and over, aggregating some 13,700,000 dead-weight tons. At the same time the Commission has custody of 2,275 war-built vessels which are for sale. Of this number, 1,687 vessels are merchant vessel types and available for sale as such. The others are military type vessels not convertible to merchant ships except at prohibitive cost. The total dead-weight tonnage represented by these surplus vessels was not stated in the hearings.

This situation raises an important point, however, which is the case for continuing a program of subsidized construction of merchant vessels while at the same time holding and offering for sale, at much less than original cost, a fleet considerably larger in number than that now actively engaged in carrying our foreign commerce. It should be said that the Maritime Commission is also engaged in contracting for the construction of certain prototype vessels for naval use, and certain so-called "national defense tankers," beyond the subsidized construction. The issue raised here does not extend to these craft.

A long-range test that might be applied to determine when the merchant marine had been built up to an adequate level is the proportion of recovery under the operating-differential. If there is a sufficient volume of goods to be handled, the shipping companies can handle the traffic and earn enough over the recapture period to reimburse, fully or in large part, the operating subsidies paid. As the tonnage of the merchant marine approaches the saturation point, the competition for traffic and the greater number of ships among which the traffic must be apportioned, will tend to reduce earnings to a level at which there would be little or no recapture in the overall. Such a situation should be regarded as evidence that no profitable use was in prospect for a further increase.

This would leave the national defense aspect as the sole support for continued construction regardless of cost. The dilemma here is akin to that confronting the aircraft industry. It is that there must be held together a sufficient nucleus of organization, capital, and technical skills in the ship building industry to provide the basis for quick expansion in the event of a war emergency. The Maritime Commission stated, in its 1947 annual report, that minimum employment of 35,000 is considered by the armed forces to be essential to the maintenance of a healthy industry. The amount of annual subsidy required to attain this goal is not capable of precise determination. For the present purpose it is suggested that \$75 million might be sufficient.

Public Roads Administration. In Chapter 4 it was shown that except for the public domain states and a small number of others, it would be entirely possible for the great majority of states to provide for their own highway needs if the federal taxes on gasoline and lubricating oil were repealed, thereby enabling the states to pick up more revenue from highway user sources without an overall increase of tax burdens on motorists. The obligation of the federal government to assist in highway construction in those states in which it is the largest land owner was recognized. The number of other states that are likely to have small deficiencies in tax yield as compared with the grants apportionable to them is small and the total deficiency would be negligible. It is suggested that a total of \$50 million annually would amply suffice as the federal share, to be devoted primarily to grants in the public domain states and the occasional marginal cases that might arise.

The National Advisory Committee for Aeronautics. This Committee was established in 1915. Its principal function is the conduct of basic aeronautical research necessary to the practical development of aircraft. The major emphasis in the research program appears to have been in the field of military aircraft and for this reason it would be proper to treat the expenditures made as part of the cost of national defense. But the statement of research policy approved March 21, 1946, contained a paragraph to the effect that NACA should endeavor to direct an increasing proportion of its research effort to the technical problems of civil aviation

with a view to their practical solution.⁵ It is, therefore, equally proper to regard the activity of the NACA as a contribution to the promotion of private economic and business activity.

The appropriations to the Committee have risen rapidly, from \$1,826,000 in 1940 to \$47,905,000 in 1949, with a contract authorization in that year of \$18,200,000. Its requests to the Budget Bureau for 1950 were, for salaries and expenses \$57,144,000 and \$107,463,000 for construction. The appropriation act for 1950 (P.L. 266) carried \$43,000,000 for salaries and expenses, \$10,000,000 for construction and equipment, and an additional \$10,000,000 in contract authorization. The House subcommittee on appropriations commented as follows:

The number of personnel provided NACA in recent years has increased tremendously and the committee is of the opinion that its operations have now reached a leveling-off place and that employees required in connection with the operation of newly constructed projects should be secured through a redistribution of personnel from less urgent activities....

As in the case of the request for salaries and expenses, the committee is of the opinion that the construction activities of NACA have reached a leveling-off point and that future appropriations for construction should be made as a result of previous authorizations in the appropriate legislative committees.

Other Regulatory Commissions. The general philosophy of the Hoover Commission's reports on the regulatory commissions has already been indicated. Among those listed in Table XIX, the only one found to be exercising administrative functions was the Interstate Commerce Commission. The Hoover Commission proposed that the divisions of ICC in charge of railroad safety and locomotive inspection be transferred to the Department of Commerce. The total current cost of these divisions is some \$1,600,000. The transfer was proposed in the interest of the overall objective of segregating administrative and quasi-judicial functions, and not with any thought that these functions would cost less wherever they might be lodged.

The Panama Canal. The Panama Canal is a self-supporting enterprise, in the sense that the appropriations made each year

⁵ The entire statement is given on pages 894, 895 of the *Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, on the Independent Offices Appropriation Bill for 1950, Part 1.*

tend more or less to equal the receipts from tolls and other charges which are covered into the Treasury as receipts. The House subcommittee on the 1950 appropriation bill commented on the need of toll rate revision, a matter last dealt with in 1937. In view of the great advances that have occurred since that time in operating costs, it would appear that some increase of charges would be entirely reasonable. In any event, there should be every precaution that the Canal is permitted to earn enough to cover its current costs.

The Alaska Communications System. The appropriation under this heading is made to the Signal Corps of the Army. Prior to the last war the system served primarily the civilian population and business interest of the Territory, but its worth and importance for military purposes are fully recognized. The House committee on the 1950 appropriation bill stated that operation of the system is now self-sustained except for items of pay, subsistence and medical care for military personnel.

* * * *

Conclusions:

1. The constitutional provisions which give the federal government regulatory powers in the field of foreign and domestic commerce have been more and more broadly interpreted, thus conferring on the federal government authority to engage in any and all activities under the guise of "promoting the general welfare."
2. Federal regulatory and supervisory activities have thus been greatly expanded, in many directions.
3. The largest element of cost in these functions is now for promotional rather than regulatory activities.
4. Under the proposals of this program federal expenditures for the promotion and supervision of economic activities may be reduced from the 1949 level of \$1,122 million to \$500 million in 195X.

Recommendations:

1. Department of Commerce
 - a) Eliminate the Office of Technical and Scientific Services
 - b) Reduce the costs of the Civil Aeronautics Administration
 by:

- 1) designating federal aid to airports more cautiously
- 2) delegating greater responsibility to state aviation commissions
- 3) transferring greater shares of operational costs to municipalities and private airlines
- c) Eliminate duplication of activity between the Civil Aeronautics Board which is purportedly a regulatory authority and the CAA whose jurisdiction is the enforcement of regulations: specifically, overlap in accident investigations.
2. Elements of federal grants-in-aid and direct subsidies for defense purposes should be charged to defense budgets.
3. The national defense aspect should be the sole basis for the continued subsidization of ship construction.
4. Federal participation in highway costs should be limited to the public domain states. (See also Chapter 4.)
5. Consideration should be given to increasing the charges for use of the Panama Canal.

CHAPTER 8

THE CONSERVATION AND DEVELOPMENT OF NATURAL RESOURCES

The federal agencies that have large responsibilities for the conservation and development of natural resources are the Departments of Agriculture and Interior, the Army Corps of Engineers, and the Tennessee Valley Authority. In one respect the Atomic Energy Commission may be listed here, but its principal operations thus far have been so directly connected with national defense that the cost of this agency is classified as part of the defense total. There are various other federal agencies which perform services of one sort or another in the conservation and development field, but the scope and the cost of such services are incidental to their major responsibilities.

The growth of interest in and concern for the conservation of natural resources has been primarily a development of the last half-century. The prevailing attitude of the people and the government during much of the 19th Century was that the resources of this country were virtually inexhaustible, and this conception led to the toleration of many wasteful practices. With a reversal of emphasis in the direction of conservation, the public expenditures for resource conservation have grown steadily. This expansion has brought problems of definition and policy determination that have not been squarely faced in all instances.

The most important policy issue is that of the proper part that government can and should play in a conservation program. To a very large extent the resources of soil, minerals, metals, and timber, about the conservation of which there is deep and growing concern today, have long since passed into private ownership. The same situation prevails, to a certain degree, in the case of water resources, although the federal government has jurisdiction over navigable streams, subject to such private water rights as may have been

granted. According to the theory of private property ownership and private incentives to economic action, all property owners should be, by nature, conservationists, for it is obvious that prudence in the use of a capital resource will prolong the period over which it will yield income, and will also assure a larger income. In too many cases, however, a predatory, short-run view has prevailed, with the result that limited, valuable resources have been wasted.

The problem of government's place and part can be stated thus: How far can and should government go in the imposition of controls and restrictions upon private owners of property, under a program of resource conservation, and still preserve the essential freedoms of economic discretion and economic action that are the basis of a free, competitive, enterprise society?

The solution can be approached from each of two opposed extremes. On one hand, the maximum of resource conservation would be attained in a completely controlled and regimented community, in which there would be vested in some governmental authority the power to prescribe the use to be made of every acre of farm land, the cutting and planting of trees, the extraction of underground resources, and so on. There is some question as to the efficiency of such regimentation in promoting genuine conservation, but there is no question whatever as to its destructive effects upon individual freedom and initiative. At the opposite extreme from complete central dictation and planning is the policy of developing good standards and procedures of conservation practices, disseminating information regarding these standards and procedures, operating where necessary pilot farms, mines, or timber tracts for demonstration purposes, and inculcating among all owners and users of natural assets a higher regard for the long-range values involved.

By and large, it can be said that the public conservation policies applied in this country have been closer to the latter than to the former concept of the role of government. A vast amount of research has been done in conservation techniques, and a considerable amount of money has been wasted here because of duplications and uncoordinated attacks upon various problems. But the total research effort has been substantial and of great value. The

several state agricultural experiment stations operate model farms in demonstration of modern methods of animal husbandry and tillage. The Forest Service has contributed to the development and advance of timber conservation practices. Other agencies have made significant contributions. All in all, it can be said that there has been a definite and reasonably intelligent effort, over a broad front, to do the kind of thing that government can and should do by way of leadership, advice, and demonstration in the conservation and development of the nation's natural resources.

The activities and expenditures of government, especially of the federal government, have been extended increasingly, however, beyond the limits and the purposes of bona fide conservation, although still largely under the guise of this objective. That is, there has been a steady and rapid increase of public expenditures, more or less under the cloak of conservation, for purposes other than genuine conservation of resources. For example, in the case of agriculture, large expenditures have been made to protect the relative income status of individual farmers, notwithstanding that the real effect of these expenditures may be to induce more rapid exhaustion of basic soil resources by extreme cropping. In the case of water resources, a substantial portion of the expenditure has gone into facilities for government production and distribution of electric power in competition with private power production. As a result of this expansion in various directions, the federal government has become committed to the payment of large amounts as subsidies of different types, for purposes which have, too often, only a remote and vague connection with conservation.

It is apparent, both from the underlying theory of subsidy payments and from consideration of such a system in practical operation, that it involves an extension of controls. Those who accept subsidies of any sort inevitably forego, to some extent, the rights and prerogatives of property ownership. It is as true of the individuals and business concerns that accept subsidies as it is of the local governmental units that accept grants-in-aid, that the greater the degree of dependence upon the subsidy or grant, respectively, the less is the resistance that can be offered against expanding controls. Private business in the one case, or local public business in the other, is thus forced more and more under the control of the

central government. The subsidy to individuals and the grants to local governments are therefore effective implements for the creation of the all-powerful central state which is the necessary preliminary to any form of totalitarianism.

The Hoover Commission reports have brought to general public attention the appalling state of disorganization, competitive duplication, and general confusion that has developed in the agencies operating in the area of natural resources. For the correction of this condition, so conducive to waste and inefficiency, the Commission proposed some sweeping shifts of responsibilities. Those which relate directly to conservation were the following:

1. Bureau of Land Management (except minerals) from Interior to Agriculture;
2. Flood control and river and harbor improvement from Corps of Engineers to Interior, where it would be consolidated with Bureau of Reclamation;
3. Investigation of natural gas resources and power planning from Federal Power Commission to Interior;
4. Bureau of Commercial Fisheries from Interior to Commerce.

The principal result of these proposed transfers would be to bring all aspects of public land management together in the Department of Agriculture, which now has jurisdiction over the national forests; and to bring all aspects of water and mineral resource conservation and development into the Department of the Interior. Thus, in theory, each department would specialize in certain aspects of the general problem of natural resource conservation. The Commission did not accept a recommendation from its task force that a new Department of Natural Resources be established and that the Interior Department be abolished.

Some members of the Hoover Commission filed vigorous dissents to the proposal that the Corps of Engineers be eliminated from river and harbor improvements and flood control. The rivalry that is reflected in these opposed viewpoints has already been very costly to the taxpayers and will become much more so unless steps are taken to end it. There is no need to take, here, one side or the other in this controversy. In fact, the most important aspect of the whole matter, from the standpoint of the program proposed in this report, is one which was not emphasized by the Hoover

Commission, and was dealt with only inadequately in the task force reports. This is the question of the extent to which the federal government should engage in power production and distribution in competition with its own citizens and taxpayers.

The Hoover Commission task force report on Water Resources Projects gives the following data on the projected federal program of power installations in relation to the capacity of the private power industry. At the end of 1947, the installed generating capacity of federal plants was reported at 4,908,700 kilowatts, as against 41.5 million kilowatts of privately owned capacity. The present programs of the executive departments and agencies contemplate an ultimate installed generation capacity of 45,968,900 kilowatts. Thus the proposed increase of 41 million kilowatts of government-owned capacities over the amount installed in 1947 is equal to the entire capacity developed by private investment from the beginning of commercial power production in 1882 to 1947. The same task force report presents an estimate of total construction cost for this proposed expansion of \$41.4 billion. The following paragraph summarizes the issues thus:¹

If brought to completion, these hydroelectric projects, plus all presently installed hydroelectric capacity, will exhaust a considerable portion of the further hydroelectric possibilities in the Nation. It should also be noted that generally the better hydroelectric sites in the United States have already been developed. Many of the projects now proposed to be built by the Federal Government are at remote locations, involving relatively long distances from the load centers and hence will require very substantial transmission investment.

The secret of the origin and growth of a power program of such dimensions is to be found in the unrestrained competition of the two agencies that are principally involved in its development, namely, the Bureau of Reclamation and the Corps of Engineers. In addition to the glaring examples of duplicate surveys and estimates of the same project at approximately the same place on the same river, each of these agencies has ranged far and wide in staking out claims to additional projects, and this has contributed to the selection of the remote, obviously uneconomic projects referred to in the above excerpt from the task force report. The Hoover Commission proposed a Board of Impartial Analysis to

¹ Task Force Report, *Water Resources Projects*, p. 7.

review and report to the President, the Congress and the public on project proposals. It also recommended that the Department of Agriculture be permitted to review irrigation and reclamation projects and report thereon to the Board of Impartial Analysis.

The following statement by Mr. W. E. Warne, First Assistant Secretary of the Interior, in reply to a question regarding their relations with the Corps of Engineers, is enlightening:²

Well, I would like to be able to say that it is all peaches and cream. I can tell you it is nearly all. We have had one or two problems that have not been, so far, satisfactorily worked out between the two agencies. One of them relates, for example, to the Jamestown Dam on the James River, for which preconstruction funds have been appropriated to both agencies. As you know, this dam is specifically authorized by law for construction by the Bureau of Reclamation. It is an integral part of our Missouri-Souris division and will be used also for direct irrigation of the Jamestown unit lands. . . . I feel that some means ought to be found to keep from building two dams at that site, and I hope that it will be, of course. We have not endeavored to do that as yet.

And, of course, if the Corps of Engineers does nothing about it, either, there may be two dams built at that site. Apropos of the Jamestown irrigation project, the soil conservation witnesses of the Department of Agriculture described to another appropriations subcommittee the educational and selling job that they had in persuading the farmers of that section to go in for irrigation.

The ease with which appropriations and authorizations have been obtained for multiple-purpose river developments and also for reclamation projects has promoted carelessness and inattention to basic preliminary research, particularly with respect to soil and hydrologic conditions. The Hoover task force report on National Resources comments as follows:³

Though the necessity for more adequate data has long been recognized, we find ourselves embarking on the most gigantic water projects ever devised with alarming gaps in our knowledge of the probable behavior of the waters we are trying to control and utilize. So serious are these deficiencies that it is estimated on the basis of experience that the limit of error or ignorance in present water developments is rarely less than 25 percent, and is frequently greater than that.

Losses due to lack of adequate hydrologic data have always been heavy and may reach staggering sums during the next few years. The most spectacular form which such losses take is the failure of dams as a result

² *Hearings on Interior Department Appropriation Bill, 1950, Part 2, p. 455.*

³ *Task Force Report, Natural Resources, pp. 18, 19.*

of overtopping by floods. In a large proportion of the important dam failures of this kind, structures were built too weak or too small because of lack of sufficient information as to precipitation, run-off, stream flow, etc. Made cautious by the number of such catastrophes in the past, engineers now tend to overbuild where adequate data are lacking, and as a result we have an increasing number of over-elaborate spillways, power plants, and water-supply systems. Losses from overbuilding of structures are less spectacular than those that occur from underbuilding, but may turn out to be even more costly.

The same report emphasized instances of loss caused by exaggerated estimates of the quantity of water available for irrigation, and cites the grave uncertainty that exists, at this late date, with respect to the adequacy of the water supply in the Missouri River Basin to fulfill all of the plans for navigation, irrigation, power development and so on that have been advanced thus far. Siltation of reservoirs is cited as another common form of loss, the source of which is inadequate data concerning sedimentation.

The failure to appropriate funds for these kinds of research is said to be the principal reason for the slow accumulation of pertinent data. But it must also be said that the ease with which funds could be obtained probably tended to diminish the concern over the importance of proceeding more cautiously and more soundly. The task force report cited above suggests that the assumption by the federal government of the entire cost of reservoir projects, instead of requiring state participation as under earlier laws, has removed one of the most effective restraints on the undertaking of projects of doubtful feasibility. This report added:⁴

States and localities were certain to scrutinize proposed projects with great care when they had to bear a significant part of the cost, but are inclined to ask fewer questions when the Federal Government supplies all the funds.

The significant fact that is overlooked in this statement is that the citizens of the states bear the cost of the federal mistakes in one way if not in another.

In line with the principal aims and purposes of the program of re-allocation of service responsibilities and fiscal resources that is offered here, it is recommended that the federal government should halt all further projects for power generation and distribution. The general responsibility of the national government for

⁴ *Ibid.*, p. 21.

leadership in flood control and conservation measures is recognized. These objectives are not consistent with power development, because of the diametrically opposed requirements of empty reservoirs for flood control and full reservoirs for steady power production. The soil conservationists do not appear to be in entire accord with the flood control doctrinaires, for the former appear to stress principally the control of run-off at the places of origin, by planting of grasses, shrubs, and trees, by contour and terrace farming, and by building catch-basin reservoirs, as against the immense downstream dam, levee, and other costly developments which are favored by the flood control group.

The following recommendations by the task force report on Water Resources Projects are in line with the general position taken here. These recommendations are:⁵

1. A return to the policy of requiring local contributions.
2. Control of non-navigation uses of water at Government reservoirs by States.
3. The Federal power policy should provide for the utilization of the facilities of privately owned utilities in marketing the power from Federal dams. The privately owned company could: (a) Build the power house and install the generating equipment at each Government dam where feasible, paying taxes on these facilities and also paying the Government for the use of falling water and the dam, with the Government retaining full control over each dam and operating it for the primary purpose of flood control, reclamation or navigation or a combination thereof; or (b) lease the powerhouse and generating facilities, as is done now at the Hoover Dam; or (c) purchase the power output under long-term contracts, entered into in advance of construction; and, in any case, should (d) build the transmission facilities needed to market the power from Government dams, and pay the taxes on such transmission facilities.
4. The Federal Government should not build, or acquire in the future, any thermal plants for the generation of electrical energy that is to be sold. (This excepts power plants for Navy ships, Army or Navy posts, and similar installations).

⁵ *Op. cit.*, p. 47.

It would be extremely enlightening to have as clear a distinction as possible between the services, and the payments, which are genuinely contributory to the conservation objective and those other services and payments which have been established as a means of subsidizing certain groups and geographic sections. All subsidies should be segregated and clearly identified as such. This would necessarily involve a statement of the purposes of the various subsidies, and such information would enable the people to arrive at better judgments concerning the desirability of these payments.

The expenditures, appropriations, and estimated requirements of the agencies included in the category of conservation and development of natural resources are shown in Table XXIII.

TABLE XXIII

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE AGENCIES CONCERNED PRIMARILY WITH THE CONSERVATION AND DEVELOPMENT OF NATURAL RESOURCES
(Thousands)

Agency	Actual Expenditures		Appropriation,	Proposed
	1948	1949	1950	195X
Department of Agriculture	\$923,104 ^a	\$942,041 ^a	\$633,030 ^b	\$312,000
Department of the Interior	349,252	472,248	582,819 ^c	368,500
Corps of Engineers (civil)				
Rivers and Harbors	113,684	160,229	199,436	100,000
Flood control	245,197	400,434	434,442	200,000
Sub-total, Engineers	358,881	560,663	633,878	300,000
Tennessee Valley Authority				
Appropriated funds	\$33,359	\$28,360	\$64,188	\$50,000
Total, Conservation and Development	\$1,664,596	\$2,003,312	\$1,913,835	\$1,030,500

a. Expenditures for 1948 and 1949 exclude payments by Department of Agriculture for foreign aid.

b. The 1950 appropriation bill provided authorizations for Treasury loans to R.E.A., \$350 million, and Farmers' Home Administration, \$103 million.

c. Permanent and indefinite appropriations totalling \$51,339,431 are set out separately in 1950 appropriation bill. These expenditures are included in actual figures for 1948 and 1949.

The expenditures of the various agencies that are primarily concerned with resource conservation and development, summarized in Table XXIII, include the costs of the activities which are

essentially conservationist in character and also the payments which are essentially subsidies. The table does not include the entire cost of the subsidies in this area, for it does not show the large payments being made by government corporations, chief among which is the Commodity Credit Corporation. The operations of these corporations will be dealt with in a subsequent chapter.

The Department of Agriculture.

The story of the Department of Agriculture since its establishment in 1862 is one of small beginnings, slow growth for more than half a century along the lines of the original conception, and of sudden, enormous expansion during the past 30 years under the impetus of political and economic forces. In 1912 the total expenditures of the Department were \$16.7 million, and twenty years later, in 1932, the total was \$22.1 million, or less than 10 percent of the estimated total for 1949. Prior to the first World War the principal function was research in agricultural problems and the dissemination of information. The state cooperation principle was introduced early, by providing for joint research and local applications thereof through the state agricultural experiment stations.

The immense expansion of departmental activities has come through the development of programs for supplying farm credit, soil and land use conservation, control of the production and marketing of farm products, and the application of policies designed to support farm prices and farm incomes. In Table XXIV, the actual and estimated expenditures of the Department of Agriculture are arranged to show, roughly, the division between the functions and activities that are essentially of a general administrative, research, and educational character, and those that involve elements of subsidy and support in one form or another. Again it should be noted that the Commodity Credit Corporation operations are not included.

TABLE XXIV

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE DEPARTMENT OF AGRICULTURE

Part 1 — Mainly general administrative, research, and educational activities
(Thousands)

Agency	Actual Expenditures		Appropriation,	Proposed
	1948	1949	1950	195X
Secretary's Office	\$1,996	\$3,971	\$2,143	\$2,000
Research and Marketing Act	5,856	13,356	19,000	15,000
Office of Solicitor	2,072	2,195	2,235	2,000
Office of Information	2,092	2,474	1,249 ^a	1,300
Library	644	673	713	700
Bureau of Agricultural Economics	4,041	4,562	4,647	4,000
Office of Foreign Agri. Relations	506	530	576	500
Extension Service	27,152	31,020	27,852 ^b	2,000
Agricultural Research Admin. :				
General	2,215	1,903	2,674	
Experiment stations	7,508	7,686	7,976	
Bureau Animal Industry	41,007	15,018	23,717 ^c	
Bureau Dairy Industry	1,016	1,107	1,093	
Bureau Plant Industry	7,867	8,645	8,420	Not
Bureau Entomology	10,320	11,166	11,136	distributed
Bureau Agri. and Ind. Chemistry	5,527	5,971	5,662	
Bureau Human Nutrition	809	836	853	
Sub-total. A.R.A.	76,269	52,324	61,531	50,000
Control of forest pests	4,143	4,294	4,970	5,000
Forest service (including roads)	70,217	81,698	52,978	50,000
Flood control	3,798	5,886	9,500	8,000
Marketing services (P.&M.A.)	9,166	9,857	10,469	9,000
Commodity Exchange Control	495	557	558	500
Sub-total	\$206,375	\$213,397	\$198,421	
Miscellaneous	11,093	2,657	—	
Total, Research, Educational (Footnotes at end of table.)	\$217,468	\$216,054	\$198,421	\$150,000

TABLE XXIV (Concluded)

Part 2 — Control, Subsidy, and Lending Operations
(Thousands)

	Actual Expenditures		Appropriation,	Proposed
	1948	1949	1950	195X
Soil conservation service	\$41,581	\$47,852	\$52,174	
Marginal land utilization	1,367	1,674	1,225	
Production and Marketing admin.:				
Conservation and Use of Agricultural Land Resources	211,775	148,305	257,043	
Acreage allotments and market quotas	24,702	—	30,151	For details see Table XXVII
Sugar Act	60,293	55,947	60,000	
Other P. & M. A.	61,328	108,365	150	
Sub-total, P. & M. A.	358,096	312,617	347,344	
Farmers' Home Administration	60,907	122,855	23,249 ^d	
R. E. A.	238,930	304,542	6,063 ^e	
Federal Crop Insurance Corp'n	4,453	—4,321	4,054	
Farm Credit Administration	302	—59,232	500 ^f	
Total, Part 2	\$705,636	\$725,987	\$434,609	\$162,000
Grand total, Dept. of Agri.	\$923,104	\$942,041 ^g	\$633,030	\$312,000

- a. Printing appropriation distributed to the various agencies in the 1950 appropriation.
b. In addition, a permanent appropriation of \$4,704,710.
c. Large expenditure in 1948, and by Commodity Credit Corporation advance in 1949, for eradication of foot and mouth disease not continued in 1950 appropriation.
d. And authorization to borrow \$103 million from the Treasury.
e. And authorization to borrow \$350 million from the Treasury.
f. And assessments against member institutions not to exceed \$2,294,000.
g. Expenditure of \$1,653 million by Commodity Credit Corporation not included.

The reduction of the grand total in 1950 is apparent, not real. The data for the years 1948 and 1949 include the expenditures by the Farmers' Home Administration and the R.E.A., and the 1950 Act provides for expenditure by these agencies up to certain amounts, to be obtained by Treasury loans. Assuming that the maximum loans authorized for 1950 were to be spent in that year, the total expenditure of the Department in that year would be almost equal to that for 1949.

The important disclosure that is made by the foregoing arrangement of the agencies and services of the Department of Agriculture is the comparatively small part of the total that is devoted to the scientific, educational, and leadership activities of the Department. Even so, it has been emphasized, both by the

Hoover Commission and by the House subcommittee on the agriculture appropriation bill for 1950, that there is much duplication, and in many places, multiplication, of agencies and services. In the case of agricultural research, for example, there is a constant problem of adjustment between the research being done under the Research and Marketing Act of 1946 and the Agricultural Research Administration established by administrative order in 1941 to bring under one general authority the various "old-line" research bureaus. It was brought out at more than one place in the Hearings on the 1950 appropriation bill that RMA funds were frequently allotted to the old-line agencies, thereby negating the intent of Congress in reducing the appropriations of these agencies. The chief administrator of the Research and Marketing Act made the following statement in the 1950 hearings:⁶

For the record I would like to make this statement about duplication. If you take the broad title that we are using in RMA and the broad title of work under regular funds, you might well accuse us of duplication. Our final measuring stick is down at the work level or the line project. But that line project is a part of a broad field. If we find a proposal would cause duplication at the line-project level, then we say that the project cannot be approved.

The House subcommittee said, in referring to the practice of making RMA grants for research to the old-line bureaus:⁷

Many of these allotments are for research projects which are so similar to the projects which have been carried on in the past from regular appropriations that it is frequently difficult to distinguish between the old-line research project and the new research project set up under the allotments from the Research and Marketing Act. There have been instances where the Congress has made specific reductions in appropriations for the regular bureaus which have been offset — in some cases more than offset — by allotments from the Research and Marketing Act appropriation. In certain instances, some very fine distinctions have been drawn to preclude the inference that bureaus have recouped their losses in the regular appropriations by securing allotments from the lump-sum appropriation under the Research and Marketing Act.

There appears to be no good reason for the maintenance of a double-barreled agricultural research organization, each operating

⁶ *Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, on the Department of Agriculture Appropriation Bill for 1950, Part 1, p. 189.*

⁷ Subcommittee of the House Committee on Appropriations, *Report on the Department of Agriculture Appropriation Bill for 1950*, p. 6.

under a separate appropriation and each tending more or less inevitably, despite good intentions and precautions, to duplicate work being done by the other. Earlier in its Report,⁸ the House subcommittee commented on the amount of bookkeeping and the number of personnel that are required to see that there is no duplication. It then offers a statement which is applicable throughout the federal service, and goes far to explain the sprawling, cumbersome federal organization. It is as follows:

This situation has come about largely by reason of the practice of passing a new act every time something new comes up rather than amend the old.

As examples of the practice referred to, the Committee points out that the Office of Experiment Stations gets its funds from eight different acts or authorizations, and the Extension Service from nine different authorizations. It was emphasized that the legislation under which the department operates badly needs codification and consolidation, and that action to this end would save time, personnel, and, of course, money.

The federal grants to the states for experiment stations and extension services illustrate the effect of long-established custom and habit. This is another case of a federal grant which, in the beginning served well to stimulate interest and activity in a program and which is still continued, notwithstanding that the need for federal aid has long since passed and the value of the trivial amounts granted can be of no financial significance to the recipients. In the case of the experiment stations, the federal grants may be summarized as follows:

Hatch Act, 1887, \$15,000 to each state, no matching requirement.

Adams Act, 1906, \$15,000 to each state, no matching requirement.

Purnell Act, 1925, \$60,000 to each state, no matching requirement.

Bankhead Jones Act, 1935, original appropriation of \$3 million, to be distributed on the basis of rural population; funds available on a matching basis. The Research and Marketing Act

⁸ *Ibid.*, p. 3.

amended Bankhead-Jones by providing a more complicated distribution formula, to-wit: 20 percent of appropriation divided equally among states; 26 percent on the basis of rural populations, and 26 percent on the basis of farm populations. In the Hearings on the 1950 Agriculture appropriation bill, it was explained that the apportionment factor of farm population was introduced because some northern states had large numbers of persons, such as miners in Pennsylvania, who were classed as rural population but were not part of the farm population.⁹ The total grants under these acts and some separate laws relating to Alaska and Hawaii were \$10,559,000, including \$813,000 set apart as a regional research fund. It is useless to pretend that this small total is necessary now to maintain state interest and activity in agricultural experimental work, although any proposal to eliminate these token grants would no doubt cause great uproar. Practically, the continuance of the grants provides the leverage for federal inspection and supervision of the various state agricultural research and experimental programs.

The extension service is essentially educational. It was inaugurated by the Smith-Lever Act of 1914, which authorized a fund of \$5 million, from which each state was to receive \$10,000 without matching, and its proportionate share of the balance on the basis of rural population, provided the federal grant were matched from state funds. Various subsequent acts brought the total of federal grants to some \$30.5 million in 1949, against which the states were reported to be providing \$35.2 million. Here is another instance of the tendency of a grant to become perpetual, regardless of the extent to which it may have served fully its original purpose of initiating a program and have long since ceased to be necessary as a continuing stimulus.

The Hoover Commission has pointed up clearly one result of the many ways in which the Department of Agriculture has duplicated or multiplied its personnel and its control and supervisory activities. For one thing, the Department has not adequately recognized and taken advantage of state organizations. On this point the Commission said:¹⁰

⁹ *Op. cit.*, p. 458.

¹⁰ Report on the *Department of Agriculture*, p. 13.

The state governments operate effective agricultural departments. They have in the past engaged in effective cooperation with the Department at State, county, and farmer levels. In recent years the Department has not taken full advantage of the established and effective State organizations in performing many agricultural programs and has thereby produced some duplication of national and State effort at local levels.

On the subject of duplication the Commission continued as follows:

For example, 47 employees attached to 7 distinct and separate field services of the Department of Agriculture in 1 cotton-producing county in Georgia were working with 1,500 farmers; a fruit and grazing county in the State of Washington has 184 employees of separate field services working with some 6,700 farmers; a dairy county in Maryland had 88 employees attached to these field services working with less than 3,400 farmers. In these and other counties, representatives of each agency frequently advise the same farmers on the same problems. Farmers are confused and irritated, as climaxed in one Missouri county, where a farmer recently received from five different agencies varying advice on the application of fertilizer on his farm.

The Hoover Commission recommends that the existing multiplicity of county advisory committees for farmers be abolished and in lieu thereof there be only one committee in each county. The cost, it was estimated, should not exceed \$700,000 a year, as against more than \$5 million for the present series of such committees.

It is apparent that the normal, long-run cost of the original, historic functions of the Department of Agriculture in the fields of agricultural research, educational leadership, and dissemination of information regarding all trustworthy improvements in modern agriculture should cost less than \$200 million annually. Elimination of the grants which were once useful but which are no longer required to sustain interest and action at the state level, and reorganization of the media through which the Department maintains its state and local contacts, as advised by the Hoover Commission, should bring the cost of the services summarized in Part 1 of Table XXIV down to not more than \$150 million annually.

The subject matter covered in Part 2 of Table XXIV involves some highly controversial issues. The principal classes of expenditure involve subsidies under the soil conservation and agricultural

land use programs; control, under the acreage allotment and market quota system; and lending, mainly through the Farmers' Home Administration and REA.

Soil Conservation and Land Use. The existence of two agencies, operating under separate appropriations in the same general field, always raises the possibility of duplication. The Soil Conservation Service appears to deal chiefly with erosion and similar physical matters of land and soil conservation, while the operations of the Production and Marketing Administration in the conservation and use of agricultural land resources have to do with management practices such as crop rotation, fallowing, use of nitrogenous crops, and other so-called soil building practices including application of lime and fertilizers. The Department does not concede that duplication exists, but the Hoover Commission task force on the Department of Agriculture states that employees of the two services have been known to make different conservation plans for the same farm.

The Production and Marketing Administration reimburses farmers for certain types of expenditure which are specified as conservationist by regulations. Normally, the ratio of reimbursement is one dollar for every two dollars spent by the farmer. The Hoover Commission task force offered the following comment on this policy:¹¹

The amount of real conservation accomplished by these incentive payments is open to question, as is also the degree to which the soil-conserving practices were induced by such payments. The money is paid to each farmer on a year-to-year basis without regard to his having improved his soil-handling practices or having tied those practices to a total farm plan and to a time schedule for the completion of the plan.

The Hoover Commission recommended consolidation of these and all other agencies dealing with soil, range, and forest conservation under a single bureau. The confusion arising from the situation in the case of the revested Oregon and California Railroad land grants supplies a strong argument for this consolidation. These lands, comprising 2,130,000 acres in Oregon, are administered by the Bureau of Land Management in the Interior Department. They are practically all timbered and are administered for

¹¹ Task Force Report, *Agricultural Activities*, p. 77.

timber production. In part they are situated within national forest boundaries. The task force report says:¹²

It is obvious from the checkerboard pattern of these O & C lands that where they lie within the boundaries of the national forests, one agency of government is handling all the even-numbered sections in each township and another agency of government all the odd-numbered sections.

With respect to the objectives of the conservation program, the Hoover Commission offered the following recommendation:¹³

We recommend that Conservation payments to a farmer should be restricted to those which will bring about the adoption of complete and balanced conservation programs on his farm. They should not be used as income supplements in disguise. When the conservation plan on any farm has been completed, such payments to the owner should stop.

The President's views and recommendations on the subject of paying farmers to preserve and improve the quality and fertility of their farms have shifted in a peculiar way. The following extracts from successive budget messages are illuminating:¹⁴

For the past several years this program has consisted largely of payments to farmers for application of fertilizer and other approved soil management practices. I am convinced that farmers generally are now fully alert to the benefits, both immediate and long-term, which they derive from the practices encouraged by this program. I believe, therefore, that this subsidization should continue to be reduced.

The doctrine stated in this passage is thoroughly sound, namely, that once the government has given impetus to a desirable program or policy through demonstration, research, educational leadership, and, as in the given case, through the direct stimulus of financial aid, the program may be expected to move ahead under its own power and a withdrawal of the federal financial support is both proper and possible.

In the budget message for the fiscal year 1948 a similar view was expressed, in the following words:¹⁵

A year ago the Budget Message recommended gradual reduction of these payments (i.e., soil conservation payments), and that recommendation is now renewed. More than 60 percent of the total payments go to about one-eighth of the Nation's farmers. Most of this money thus is

¹² *Ibid.*, p. 111, and map.

¹³ *Op. cit.*, pp. 17-18.

¹⁴ *The Budget of the United States Government for the Fiscal Year ending June 30, 1947*, p. LXVI.

¹⁵ *The Budget for the Fiscal Year 1948*, p. M38.

being paid to farmers who, because of their strong position in American agriculture, would undoubtedly continue the best farm management practices without the persuasion of a bonus from the Treasury.

We should shift our effort from this kind of subsidy to providing technical assistance to all farmers for soil conservation and management, along the lines of the Soil Conservation Service and the Extension Service. I therefore propose that the appropriation act limit the conservation and use program for the crop year 1948 to 200 million dollars instead of the 3-hundred-million dollar program to which we are committed for the crop year 1947.

In view of the situation disclosed with respect to the distribution of the payments, it would have been even more appropriate to propose entire elimination of these payments. The President's proposal for a greater emphasis upon technical aid and a greater utilization of the Extension Service, which is the Department's educational and informational branch, has evidently not been taken seriously, for the director of the Production and Marketing Administration said, in testimony on the 1950 appropriation bill, that the kind of information developed by PMA would not go out through the Extension Service.¹⁶

In the budget message for 1949 there came this abrupt reversal of the President's earlier position:¹⁷

In accordance with the 1948 Agriculture Appropriation Act commitments for payments to farmers under the conservation and land-use program will be reduced for the crop year 1948, causing a decline in expenditures in the fiscal year 1949. It is necessary, however, that this program be restored in order to prevent a serious reduction in the fertility of our soil as a result of the high production induced by heavy foreign and domestic demand for agricultural products. I therefore ask the Congress to make more adequate provision for the conservation and use program by authorizing a 300-million-dollar program for the 1949 crop year. Expenditures under this program will occur largely in the fiscal year 1950.

The keynote of the position taken in this study is found in the President's earlier statements. It is that as the farmers generally become aware of the immediate and long-range values of good farm management and conservation practices, and more alert to the techniques of applying these practices, the stimulus of a bonus from the Treasury will be increasingly unnecessary and should be

¹⁶ *House Hearings on Agriculture Department Appropriation Bill, 1950, Part 2, p. 349.*

¹⁷ *The Budget for the Fiscal Year 1949, p. M37.*

whittled down toward the vanishing point. If the educational and leadership job is well done, withdrawal of the subsidy should be possible; but if the guidance part of the job is not well done, the pittance paid out in bonuses will not save American agriculture.

Control through Acreage Allotments and Market Quotas. The acreage allotment and market quota system is a necessary feature of the price support system. That is, it provides a brake, in theory at least, on the volume of production which is stimulated to high levels by the price supports. Under a different system of price support, or if there were no price support, there would be no occasion for acreage and marketing control.

The Hoover Commission recommended that adjustment programs with respect to commodities and commodity groups be operated on a stand-by, rather than a continuous, basis. During the war, especially after 1943, there were no controls except for peanuts and tobacco, and the action voted year after year by the peanut growers was waived by the Secretary of Agriculture in view of the war demand for fats and oils. The Agricultural Adjustment Act of 1938 requires that marketing quotas be proclaimed when the total supply exceeds normal by 20 percent in the case of corn, wheat, and rice, and by 8 percent in the case of cotton.

Much has been made of the alleged "democratic" procedure whereby quotas are established. It is always by referendum, and at least two-thirds of the eligible voters (i.e., farmers in the sections designated as the main producing areas for a given crop) must accept the quota. The essentially involuntary character of the voting is made clear from the fact that in the event of rejection of a proposed quota, there may be no price support for that crop. Public Law 897, 80th Congress, contains the following amendment to Section 302 of the Agricultural Act of 1938: "Compliance by the producer with acreage allotments, production goals, and marketing practices prescribed by the Secretary may be required as a condition of eligibility for price support."

It is apparent that the acreage allotment and market quota system will be operative as long as there is a system of price support for farm products. The justification for the amount requested to cover the cost of this procedure contains the following

statement by the Director of PMA to illustrate the steps involved:¹⁸

It consists of collecting data and reconstituting farms (and there is a great deal of work under that); reviewing, processing, and recording basic data; determining farm-acreage allotments and yields; appraising and adjusting farm allotments and yields; considering appeals; preparing and mailing notices; holding referendum; measuring acreages on individual farms; computing acreages; preparation and issuance of market-quota notices; receiving, recording, and processing marketing reports and penalties.

Lending Operations. The two major loan agencies that are established as units in the Department of Agriculture are the Farmers' Home Administration and the REA. The nature of the loan operations and the volume of loans and repayments in each case may be briefly summarized as follows:

Farmers' Home Administration. This agency was established in 1946, as the successor to the Farm Security Administration. Its lending activities are:

1. Direct farm ownership loans to farm tenants, farm laborers, share croppers and other individuals for the purchase, enlargement, and development of family size farms. Loans up to the normal value of a farm as improved are at 4 percent, to be amortized over 40 years.

2. Insure 40-year farm-ownership loans by private lenders up to 90 percent of normal value, at 3 percent interest plus 1 percent insurance charge.

3. Make production and subsistence loans to farmers and stockmen for farm-operating expenses and other farm needs, including refinancing of debt and family subsistence. Loans are up to \$3,500 for 1 to 5 years at 5 percent interest, with a maximum of \$5,000 to any one farmer.

4. Make loans for the construction, repair, or improvement of water facilities in the arid and semi-arid areas of the 17 Western states. Such loans are at 3 percent interest for periods up to 20 years.

A cumulative record of advances and collections from inception through December 31, 1948, is given in Table XXV.

¹⁸ *House Hearings on Agriculture Appropriation Bill, 1950, Part 2, p. 336.*

TABLE XXV

ADVANCES AND COLLECTIONS, CUMULATIVE, BY FARMERS'
HOME ADMINISTRATION AND ANTECEDENT AGENCIES,
THROUGH DECEMBER 31, 1948
(Thousands)

Agency	Period	Total Loan Advances	Total Collections to 12/31/48	
			Principal	Interest
Farm Security Admin.	1936-10/31/46	\$1,004,672	\$846,277	\$114,196
Emergency Crop and Feed Loans	1936-10/31/46	575,935	464,122	46,890
Farmers Home Admin.	11/1/46-6/30/48	164,460	78,272	3,975
Totals		\$1,745,067	\$1,388,671	\$165,061

Source: *House Hearings on Agriculture Appropriation Bill, 1950*, Part 2, pp. 623, 624.

It appears from this record that far the largest part of the lending operations for the purposes outlined above had occurred before organization of the present agency, and likewise that far the largest part of the payments of principal and interest have been on account of those earlier loans. However, it is apparent that the achievements of farmers in paying, and/or of the agency in collecting, have been quite satisfactory thus far. One important reason has no doubt been the steadfast refusal of the agency to accept inflated real estate values as a loan basis. In the hearings on the 1950 appropriation bill, it was said that this policy had reduced materially the number of farms found to be eligible for loans. Another reason has been the high level of incomes received by farmers in recent years. The FHA officers have construed language used in earlier House and Senate hearings to indicate an intent to give preference to veterans, although there is no statutory requirement to that effect. In consequence, about 80 percent of current loans are being made to veterans. The caution was thrown out in the 1950 hearings that this might lead to trouble later, through overselling veterans on the advantages of farming and farm life. In any event, it is a duplication of other forms of veterans' aid.

The Hoover Commission's task force report on Lending Agencies contains statements regarding the achievements and present status of the Farmers' Home Administration which are quite at variance with the financial record summarized above. This report

recommends abolition of the agency on the ground that other agencies in the Department of Agriculture can perform all services now being done by FHA.¹⁹

The principal opportunity for duplication of FHA services with those of other agencies arises in connection with the lending operations of the Farm Credit Administration. The various groups of credit institutions in FCA are now so largely owned privately, and they derive their funds so extensively from the general money market, that they no longer constitute an element of general public expense. It is shown in part 2 of Table XXIV that the only direct federal appropriation is for some \$500,000. These facts may aid in explaining why the FCA institutions cannot, or do not, enter into the kind of lending which falls to FHA. The individual farmers who use FCA loan facilities must have a certain asset and credit standing, at least to the amount necessary for the purchase of shares in a local production credit cooperative. Many of the borrowers from FHA must be helped 100 percent from "scratch." The Hoover Commission task force report on Agriculture Activities refers to them as marginal, in terms of assets, or of managerial experience, or both. Hence, while there may be duplication as to the character of the lending operations of FHA and FCA, there is little or no actual duplication with respect to the potential lists of customers of the two institutions.

Rural Electrification Administration. The Rural Electrification Administration was established to make loans primarily to cooperative associations of farmers for electric distribution systems and for generation and transmission facilities. The loans are supposed to be liquidated within 35 years and bear 2 percent interest. Loans at the same rate of interest but for shorter periods may be made to finance consumer wiring, and the acquisition and installation of electrical and plumbing appliances and equipment.

The method of financing is by an authorization to borrow from the Treasury. From the beginning of this program through December 31, 1948, the authorizations made available have totalled \$1,875,428,000. The record of loans and payments thereon to the same date is given in Table XXVI.

¹⁹ Task Force Report on *Lending Agencies*, pp. 42-44.

TABLE XXVI

LOANS AUTHORIZED BY REA THROUGH DECEMBER 31, 1948,
AND PAYMENTS OF PRINCIPAL AND INTEREST THEREON
(Thousands)

Purpose of approved loans	Total loans approved	Payments			
		Amounts due		Amounts paid	
		Principal	Interest	Principal	Interest
Distribution	\$1,374,739	\$82,122	\$78,270	\$100,069	\$77,787
Generation and transmis- sion	186,267				
Consumer Facilities	13,919				
Totals	\$1,574,924	\$88,442	\$78,704	\$106,319	\$78,206

Source: *House Hearings on Agriculture Appropriation Bill, 1950*, Part 2, pp. 659, 660.

The record of accelerated payments of principal through the high prosperity years of the war and postwar periods is a good start. The future prospects are likely to be more uncertain and they will become dark if the ambition of the REA administrators to provide electricity in every farm homestead from some central source, regardless of the distance to be covered, is permitted full sway. In the justification of agency estimates for the 1950 appropriation, an awareness of this problem is indicated, in the following:

In many states, the more thickly populated areas are well along toward complete electrification, and efforts in the future must be directed to electrifying the 'thinner' areas and areas of difficult terrain. This requires closer planning and review in order that proposed lines may be deemed feasible, i.e., offer reasonable assurance of repayment of loans.

There is an obvious element of Treasury subsidy in the rate of interest, for the 2 percent which REA charges the local cooperatives is less than the rate which the Treasury pays on long-term debt.

The problem of expansion into areas in which the customers can never repay the costs of installation is the most serious aspect of this program. Assuming that there is to be an objective of providing every farm with electricity, however remote and isolated it may be, there must be other, cheaper ways of doing this than by carrying electric current long distances over broken, inaccessible terrain. It is assumed here that another three or four years, at the present rate of expansion, will suffice to cover all of the territory that can be equipped with a reasonable expectation of

repayment. Thereafter, the REA would become essentially an administrative agency for supervising and collecting the loans made.

Summary of Operations in Part 2 of Table XXIV. On the basis of the preceding discussion and recommendations, the following allowances are proposed for the activities covered in the second part of the expenditures of the Department of Agriculture, which are set out in Table XXIV.

TABLE XXVII

SUMMARY OF PROPOSED ALLOWANCES FOR EXPENDITURES OF THE DEPARTMENT OF AGRICULTURE WHICH INVOLVE MAINLY CONTROL, SUBSIDY, AND LENDING OPERATIONS
(Thousands)

Purpose	Proposed 195X
Soil conservation (consolidation of SCS and PMA).....	\$ 50,000
Marginal land	1,000
Acreage allotments	30,000
Sugar Act (indefinite) say.....	60,000
Farmers Home Administration (for servicing outstanding loans only)	15,000
Rural Electrification Adm. (for servicing outstanding loans only).....	6,000
Federal Crop Insurance Corporation.....	
Farm Credit Administration	
Total	\$162,000

These recommendations are based on certain assumptions and recommendations which are set forth in preceding pages. Briefly, they are as follows:

1. All soil conservation expenditures will be consolidated in one agency, and will be made for the purpose of supplying demonstrations, scientific research, and educational leadership. The earlier viewpoint of the President is accepted, to the effect that with the more complete dissemination of knowledge concerning the techniques and the advantages of soil conservation, the bait of a Treasury bonus will become unnecessary.

2. Acreage allotments must be retained for as long as there is any kind of federal price support system for agricultural commodities, since production control is a logical concomitant of the support system.

3. Expenditures under the Sugar Act are simply a distribution, to domestic sugar producers, of the amount produced by an import tax of approximately $\frac{1}{2}$ cent per pound on imported sugar.

4. The lending operations of Farmers' Home Administration

and Rural Electrification Administration will terminate before long for lack of additional customers who provide satisfactory loan risks. The subsequent operations of these agencies will therefore be limited to the servicing and collection of the outstanding loans.

5. The small appropriations made toward the administrative expenses of the Federal Crop Insurance Corporation and the Farm Credit Administration are traditional, though not essential, as both of the agencies are engaged in business operations of a nature such that all of the operating expenses could well be met by assessments or other charges against members and participants in these programs.

The Department of the Interior.

The second of the federal departments which has large responsibilities in the conservation and development of natural resources is the Department of the Interior. The recent record of expenditures and appropriations for this department, together with the recommendations for future expenditure, is given in Table XXVIII.

TABLE XXVIII
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE DEPARTMENT OF INTERIOR
(Thousands)

Division	Actual Expenditures		Appropriation	Proposed
	1948	1949	1950	195X
Secretary's Office	\$5,399	\$7,493	\$9,629 ^a	\$7,000
Bonneville Power Admin.	15,653	25,688	30,285 ^b	15,000
S. W. Power Administration	2,362	3,227	^c	—
Bureau of Land Management	4,272	5,354	5,724 ^d	5,500
Bureau of Indian Affairs	40,979	59,876	58,240	55,000
Bureau of Reclamation:				
Reclamation Fund	42,881	51,489	41,155	150,000
General Fund	133,272 ^e	192,306 ^e	312,790	
Geological Survey	13,297	15,637	15,988	16,000
Bureau of Mines	22,714	22,805	22,099	25,000
National Park Service	16,734	19,547	29,451	30,000
Fish and Wildlife Service	13,312	18,586	11,926	15,000
Government in the Territories	30,227	50,042	45,532 ^f	50,000
Totals	\$349,252	\$472,248 ^g	\$582,819	\$368,500

a. And contract authorization of \$4 million for construction of power transmission facilities, S.W. Power Admin. The Commission of Fine Arts, expenditure \$12,000 is transferred, in this study, to the section on Social Welfare.

b. And contract authorization of \$15,725,000.

c. Appropriation for 1950 included in Secretary's office total.

d. Expenditure for 1948 (\$8,150,000) and 1949 (\$12,064,000) transferred to permanent and indefinite appropriations in appropriation bill for 1950.

- e. And indefinite appropriation estimated at \$12 million.
- f. And contract authorizations of \$8 million for roads, bridges, and trails, and \$17 million for Alaska Railroad, Territory of Alaska.
- g. Excludes \$12,435,000 distributed to states and counties from special receipts, and loan to Virgin Islands Corporation by the Treasury.

The Budget for 1950 lists reimbursable expenditures of \$122,572,000 in 1948, and of \$216,956,000 in 1949. The rate of reimbursement and the proportion of eventual recovery are not given. The original conception of the reclamation program was based on the assumption that the project costs would be recovered out of payments made by the settlers over a period of years. While the sales of land in irrigation projects continue to include contract terms for payments covering certain construction costs, the sharp rise in these costs through incorporation of purposes other than reclamation of arid land, *per se*, such as power, flood control, navigation, etc., has increased the unlikelihood of full recovery. The emphasis has been shifted to the indirect fiscal advantages to the federal government from the income and other taxes collected from farmers and others in the environs of the several projects. The Bureau of Reclamation offered an estimate, in 1948, that the aggregate of federal income taxes paid by individuals on or adjacent to reclamation projects was \$1,100 million. The basis of this estimate, as published, is not particularly convincing.²⁰ Nor can such payments, even if they were fully reliable, be regarded as constituting an indirect reimbursement of the cost. The settlers on farms and in the towns developed by an irrigation project may, in some cases, have more income and pay more tax than they would have had they continued to live and work elsewhere, but they would have had some income and paid some tax wherever they might have lived had there been no reclamation development.

The Corps of Engineers.

In view of the important, and at numerous points conflicting, recommendations of the Hoover Commission with respect to the relationship of the Bureau of Reclamation and the Corps of Engineers, it is desirable to consider both agencies. Accordingly, summary data are introduced here relating to the river and harbor improvement, and flood control operations, of the Corps of Engineers.

²⁰ *Annual Report of the Department of the Interior, 1948*, pp. 78, 79.

TABLE XXIX

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS, RIVERS, HARBORS AND FLOOD CONTROL, CORPS OF ENGINEERS
(Thousands)

Service	Actual Expenditures 1948	Actual Expenditures 1949	Appropriation 1950	Proposed 195X
River and Harbor Improvement	\$113,684	\$160,229	\$199,436	\$100,000
Flood Control	245,197	400,434	434,442	200,000
Totals	\$358,881	\$560,663	\$633,878	\$300,000

Three different approaches to the complicated problem of natural resources and the construction involved in their conservation were offered by the Hoover Commission and two of its task forces. As noted above, the Commission proposed to transfer land management, except minerals, to the Department of Agriculture, and to concentrate all water development and use in the Department of the Interior, including all construction work, whether for dams, public buildings, or other purposes. The task force on Natural Resources proposed a new Department of Natural Resources, which was essentially the Interior Department enlarged to include forest service, river, harbor, and flood control, and certain conservation bureaus from Agriculture. The task force on Public Works proposed a new Department of Works and Conservation to have charge of natural resources, housing and building, territories and Indian affairs, roads and airports.

It is highly significant that in each task force plan and also in the Commission's plan, there was provision for some kind of review and analysis of the plans and schemes for reclamation, flood control, and other resource conservation projects. This is testimony to the chaos resulting from the lack of coordination and direction in this field and to the waste of public funds that has inevitably resulted. The Task Force Report on Natural Resources says:²¹

Incomparably the greatest opportunity for economy lies in the imposition of precautions to eliminate wasteful water development, and to assure the soundness of the projects finally adopted. In the past, projects

²¹ *Op. cit.*, p. 3.

have been carried through which should never have been undertaken at all. Others have been wastefully constructed, and without regard to important potential uses. Still others have been premature. Bad accounting methods have consistently underestimated costs. Inadequate basic data, interagency competition, and local political pressures bear the primary responsibility for this extravagance and waste. If the measures hereinafter proposed by the committee for obtaining more adequate basic data, for a central review agency, and for eliminating interagency competition through consolidation are adopted, savings running into the billions during the next decade or two would appear assured.

Even within the Department of the Interior there has been failure to coordinate bureau viewpoints and operations. The Director of National Parks wrote as follows in 1948:²²

A number of water development proposals seriously threaten the integrity of national parks. The National Park Service recognizes the desirability of fuller utilization, within the limits of long-term economic soundness, of the water supplies of the Nation and of effective measures for the control of floods. Many proposals for flood control, hydroelectric and reclamation impoundments, however, contemplate the invasion of parks and monuments, and the Service is obliged by law, by general public opinion, and by its own convictions, to defend these areas as vigorously as it possibly can, unless an overwhelming showing of national necessity can be made. In connection with many flood-control proposals, the Service shares with numerous conservation organizations serious doubts as to the permanent efficacy of such dam construction, and feels that more attention needs to be directed to remedying the primary causes of floods, the destructive denudation of forested watersheds, unsound agricultural practices, the failure to apply erosion controls, and conditions at the headwaters of streams.

Some of the projects which would involve destruction of the scenic and other features of national parks were said to have been developed by the Bureau of Reclamation, which is in the Department of the Interior and, presumably, under its control. Others have originated with the Corps of Engineers, which is independent of the Interior Department.

From another direction, also, has come objection to the water conservation program which indicates the need of impartial review and screening. The State of Nebraska, in which all electric power is produced by public agencies, has engaged in a prolonged contest with the Bureau of Reclamation over the use and control of water in the North Platte River. The latest stage of this controversy is found in the hearings on the Interior appropriation

²² *Annual Report of the Department of the Interior, 1948*, p. 338.

bill for 1950,²³ and relates to the Bureau plan for greatly enlarging the capacity of a proposed dam at Glendo, Wyoming.

Among the matters which must be resolved if headway is to be made toward more efficient conservation and more prudent use of public funds, the following are of particular importance:

1. The development of an acceptable conception of, and workable policy for, the most effective flood control measures. The wide disagreement among different groups of experts and students today indicates that this problem has not been solved to the satisfaction of all parties. It would appear that there has been greater concern with satisfying, in some measure, the rival claimants to the construction job, namely the Bureau of Reclamation and the Corps of Engineers, than with discovering and applying the best procedures of flood control. In the case of the Missouri River Basin project, the respective spheres of the two agencies are outlined as follows:²⁴

The Army is to build the main dams below Fort Peck and to operate them for flood control and navigation. The Bureau of Reclamation is to build the tributary dams, that is, dams on the tributary streams, irrigation projects, power plants, and transmission lines, and to transmit and market power from the whole project, including the power generated at dams built by the Corps of Engineers.

2. The development of an acceptable determination of whether or not to continue and extend the federal role in the distribution of electric power or to limit this role to power production only. Data given above indicate the existence of formidable plans for federal domination of the electric power field, in the course of which private investment is likely to be seriously damaged, or even driven from the field entirely.

It is still far from certain that private capital would not be forthcoming for the construction of hydroelectric power facilities, under proper terms of encouragement from the federal government as to construction, taxation, and so on. There has long existed, in the states, regulatory authority adequate for the protection of consumers. No private group could afford to construct dams for multiple purposes, if the requirements for such construc-

²³ *House Hearings on Interior Department Appropriation Bill, 1950, Part 2*, pp. 658-677.

²⁴ *Ibid.*, p. 337.

tion were such as to involve costs materially above those necessary for power production only.

In practice, it has become customary for the government to assert the existence of other purposes than power production, and hence to effect an allocation of costs for power alone below the amount which a private company would be obliged to incur for that single purpose. In consequence, and also because of the authority which the federal government has over navigable streams, private enterprise has had only a limited access to hydroelectric power.

The important issue is whether federal action shall stop with the construction and generation, or shall extend into distribution. The present policy calls for such extension, with additional large expenditures for transmission lines and the other equipment necessary to deliver power to consumers at ordinary commercial voltages. The position taken here is that this is an unnecessary extension of government operations in competition with its own citizens. The recommendation of the Hoover Commission task force on this point has been noted above, to the effect that the power should be sold to, and transmitted by, private enterprise, which would be subject to taxation on the properties owned and income received. This advice is endorsed here, as an excellent step toward reducing the scope, power, and cost of the federal government. Such action would automatically solve another controversial issue, namely, the further construction of steam plants to firm up the hydroelectric output. The same task force advises against such construction, and this recommendation is likewise approved here.

3. The development of a clear understanding of the part which the states can and should assume in both conservation and river improvements; and also, of the extent to which they should participate in the costs of such projects. A substantial part of both the responsibility for planning, and of the cost of executing these projects is properly referable to the states under the program for enlarging their fiscal resources that is advanced here. The Hoover Commission task force referred to above has pointed out the unwisdom of relieving the states of all financial responsibility for construction costs in the case of reservoir projects. It could have gone further and said, with equal propriety, that the states should

take over all except the very largest and most expensive river and harbor improvements within their respective borders. Many such improvements are of small cost and of equivalent value, individually, and would probably not be done if local funds had to be provided. In the aggregate, for the nation, the cost is substantial, and the principal value is political rather than economic, that is, it is the opportunity for "logrolling" that occurs in connection with their selection.

An argument advanced by the Army in support of the present share of the Corps of Engineers in river and harbor work is that it affords an opportunity of practical training and experience for army engineers. It appears that about two hundred army engineers are used in this work, together with some 9,000 civilian engineers. The Hoover task force report suggested that Army engineers could be assigned to the proposed new Department of Works, where similar experience could be had. They could also be assigned, upon request of state officials, to river and harbor improvements being undertaken at the state level.

After this brief review of some highlights of the record, attention is directed more specifically to the reasons for the amounts recommended in Tables XXVIII and XXIX above. In the case of reclamation and river development, it is assumed that there will be federal withdrawal from power distribution, as recommended by the Hoover Commission task force. This would eliminate the Southwestern Power Administration, make unnecessary the proposed Southeastern Power Administration, and a substantial part of the operating expense at Bonneville.

With respect to the future of reclamation, the Commissioner of Reclamation said:²⁵

According to present standards and current economic concepts — which will inevitably change with changing needs — we are now more than half finished with our task. That task is going to be more difficult on the home stretch. Nothing that Reclamation or the Congress can do will permit this endeavor to go on forever. The end in sight is exhaustion of water in the West that can be put to work.

Here is a viewpoint that has been encountered in REA and elsewhere. The marginal and submarginal extensions become more

²⁵ *Op. cit.*, Part 2, p. 142.

and more costly, and beyond a certain point they would not be undertaken, if policy were determined by any rational consideration of relative benefits and costs. At some remote time, the growth of population or other changes might bring them within the range of reasonable justification. The viewpoint taken here is akin to that which any impartial board of review would take, which is deferment of all projects not now demonstrably warranted on a sound comparison of costs and benefits.

With no expenditure for transmission and distribution equipment, and with the reclamation objective realigned to lay greater emphasis upon headwater stream conditions as the most necessary step toward flood control, it is suggested that Bureau of Reclamation expenditures need not be more than \$150 million.

The basis for the recommendations relating to rivers, harbors, and flood control is, first, the proposal that minor projects, essentially of local benefit only, be turned over to the states in which they are located, for both construction and maintenance; second, that a considerable portion of the maintenance of finished projects of a minor and local character be likewise relegated to the states; and third, that the scope and the cost of the flood control problem in the downstream reaches of our rivers will be diminished by the reclamation and conservation activities in the upstream areas. It is therefore recommended that a total of \$300 million, which is only some \$59 million less than the actual expenditure for all construction and maintenance purposes in 1948, would be adequate.

* * * *

Conclusions:

1. The problem is how far can and should government go in the imposition of controls and restrictions upon private owners of property, under a program of resource conservation, and still preserve the essential freedoms of economic discretion and economic action that are the basis of a free, competitive, enterprise society?
2. In the past, valuable natural resources of the country have been wasted because of the notion that they were inexhaustible, and the consequent predatory use of them.

3. Current and growing concern for conservation of the country's resources—most of which are now privately owned—has led to large public expenditures, and to problems of definition and policy.
4. General responsibility of the national government for leadership in conservation and flood control measures is recognized, and there has been real accomplishment in the kind of thing that government can and should do.
5. However, there has been a steady and rapid increase, under the cloak of conservation, of government activities outside that sphere and inconsistent with that aim: for example, 1) the protection of farm income by price support measures which may induce more rapid exhaustion of basic soil resources, and, 2) government production and distribution of electric power, by methods diametrically opposed to those of flood control.
6. Also, an appalling state of disorganization, competitive duplication, and general confusion has developed in the federal agencies operating in the area of natural resources.
7. Under the proposals of this program, federal expenditures for the conservation and development of natural resources may be reduced from the 1949 level of \$2081 million to \$1031 million in 195X.

Recommendations:

1. The federal government should halt all further projects for power generation and distribution.
2. In marketing the power from existing federal dams, the facilities of privately owned utilities should be used.
3. Non-navigation uses of water at government reservoirs should be controlled by the states.
4. State participation in the cost of reservoir projects should be re-instituted.
5. The research programs of the Research and Marketing Act of 1946 and the Agricultural Research Administration should be consolidated.

6. The grants-in-aid for experiment stations and extension services, now more habit than necessity, should be eliminated.
7. The media through which the Department of Agriculture maintains its state and local contacts should be reorganized.
8. All soil conservation expenditures, especially those of The Soil Conservation Service and The Production and Marketing Administration, should be consolidated in one agency, and should be made for the purpose of supplying demonstrations, scientific research, and educational leadership.
9. As the results of the educational program take hold, conservation payments to farmers will be increasingly unnecessary and should be whittled down to the vanishing point.
10. The lending operations of the Farmers' Home Administration and the Rural Electrification Administration will terminate before long for lack of additional customers who provide satisfactory loan risks. The subsequent operations of these agencies should therefore be limited to the servicing and collection of outstanding loans.
11. The appropriations for administrative expenses of the Federal Crop Insurance Corporation and the Farm Credit Administration should be discontinued since all operating expenses can be met by assessments and other charges.
12. Disagreements between the Bureau of Reclamation and the Corps of Engineers on flood control measures should be reconciled in the development of an acceptable, workable policy, with greater emphasis on headwater stream conditions.
13. Greater responsibility for planning, financing and maintaining projects for conservation and river improvement should be left to the states. The states should take over all but the very largest and most expensive river and harbor improvements. Opportunity for training and experience for army engineers need not be diminished, since they could be assigned, by request of state officials, to river and harbor projects undertaken by the states.

CHAPTER 9

PROMOTION OF ECONOMIC AND SOCIAL WELFARE

Governmental economies are generally suggested via pruning knife and trimming shears, but an ax must be laid to some of the roots of federal expenditures for social welfare if these burgeoning costs are to be cut. The expansion of social and economic programs into the largest domestic function of government has been amply demonstrated in Britain. But it is equally true at home. Activities classified in the federal budget as "social welfare, health and security" represent more expenditure than any other non-war-connected function. And the spending of all levels of government for welfare purposes is higher today than it was at the depth of the depression.

The growth of such expenditures has been relatively swift. In pre-depression years the total was a few hundred million at most. In 1932, at the beginning of the upward trend, when the federal government made its first significant expenditures in this field, the aggregate spent by the three levels of government for health and welfare purposes was in the area of half a billion. This date marked the change in the relative distribution of welfare expenditures by government levels. Prior to that time, welfare functions had been traditional and exclusive responsibilities of the states and localities. But the state of the nation was not good then. Unemployment and need were widespread. State and local resources were depleted. The great emergency had begun. With it, and the advent of the Federal Emergency Relief Administration, the national government initiated a series of programs which, over the intervening years, have led to long-term federal programming and commitments.

The necessity of the early thirties has been the mother of entrenchment. And costs have steadily risen. The peak of depression expenditures for *all* welfare purposes, for all levels of government, including WPA and other federal projects was \$3.2 billion in 1938.¹ Ten years later, at a time of unprecedented high volume of national income, the three levels of government were again spending that and more. The country's bill for the promotion of economic and social welfare is high. State figures alone for health and welfare were \$1.7 billion in 1948²; and federal expenditures, including grants to the states, for these and related functions were \$2.3 billion.

Although the welfare and security programs which stem from the Social Security Act of 1935 account for the bulk of these expenditures, there are a number of other functions designed to promote economic and social welfare. The above federal figure includes, in addition to the major items classified by the budget as "social welfare, health and security": the Office of Education in the Federal Security Agency, which the budget classifies under the separate heading, Education; the Department of Labor; the Bureau of Community Facilities which comprises a variety of health, education and relief expenditures; and certain related miscellaneous accounts such as specific-purpose retirement funds, the National Labor Relations Board and the National Mediation Boards, etc. The classification presented here excludes the item, crime control and correction, an expenditure of the Department of Justice which the federal budget classifies as welfare. The net difference in these two classifications was in the area of \$450 million in both 1948 and 1949, expenditures under the budget classification being lower.

There is presented in Table XXX an overall summary of current expenditures, appropriations, and recommendations for the federal offices and agencies dealing with activities here classified under "promotion of economic and social welfare."

¹ Social Security Administration, *Social Security Bulletin*, Feb. 1943, p. 23.

² Dept. of Commerce, *Summary of State Government Finances in 1948*.

TABLE XXX

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR AGENCIES PRIMARILY CONCERNED WITH THE PROMOTION OF ECONOMIC AND SOCIAL WELFARE
(Thousands)

Agency	Actual Expenditures		Appropriation, 1950	Proposed, 195X
	1948	1949		
Federal Security Agency	\$1,028,365	\$1,312,826	\$1,535,544	\$135,900
School Lunch Program	68,313	74,902	83,500	—
Department of Labor	86,345	15,303	51,636	16,000
Bureau of Community Facilities	68,743	19,288	— ^a	—
Railroad Retirement Board	778,364	593,589	758,589	— ^b
Civil Service Retirement	244,000	224,000	301,291	275,000
Canal Zone Retirement	1,177	1,177	999	1,000
Alaska Railroad Retirement	217	217	215	200
Foreign Service Retirement	2,085	2,150	2,187	2,000
Canal Zone Construction Annuity	1,973	2,195	5,894	2,500
Federal Mediation Service	1,917	2,754	2,725	2,700
Housing Expediter	25,339	21,615	17,500	—
Housing and Home Finance Agency	73,911 ^d	60,798	28,226	28,000 ^c
National Labor Relations Board	5,044	8,454	8,550	6,000
National Mediation Board	853	893	1,211	900
Smithsonian Institution	3,069	3,606	3,648	3,500
Totals	\$2,315,804	\$2,343,767	\$2,801,715	\$473,700

a. The Bureau of Community Facilities is merged into the new Community Facilities-Federal Aid Service in General Services Administration.

b. The salaries and miscellaneous expenses of the Railroad Retirement Board should be paid from the fund.

c. This allowance is for general administrative expenses. The Agency will spend immense sums, under present plans, partly on a give-away, partly on a reimbursable, basis. No projection of these costs is now possible.

d. In 1948, repayments exceeded all other costs by the amounts shown. They are deducted from the total.

Before proceeding with a discussion of details, some explanation of the approach that has been made to the federal expenditures of this general class in order.

First, the amounts shown as appropriations to the Railroad

Retirement Board, which correspond with the payments by the railroads and their employees, should be transferred immediately to the appropriate trust accounts, in the same manner as is now done with the payments by employers and employees for old age and survivors insurance. This recommendation is added to Chapter 12 which is wholly devoted to a discussion of the federal trust accounts. Fiscal data for the various retirement programs are included in Table XXX as a necessary part of the classification of expenditures for social and economic purposes. Exclusion of further comment here on these programs is not to be interpreted as a proposal to eliminate the railroad retirement system or any like program.

Second, the emphasis in the following discussion is centered upon the large agencies and activities, and upon such of the smaller ones as may be involved, either by reason of transfer from federal to state jurisdiction or of complete elimination. Numerous small units are carried into the final program without discussion, inasmuch as no material change is contemplated with respect to functions, supervisory responsibility, or expenditure. For example, prior to the recent transfer of the Bureau of Employment Security from the Federal Security Agency to the Department of Labor, that entire department operated on about \$16 million. This expenditure covered all federal activity, research, and leadership in the fields of labor statistics and information, labor standards and training, and labor mediation and regulation. However, the transfer of the Bureau of Employment Security not only dwarfs the basic functions of the department — which historically at least was significant enough for cabinet status — but it alters the character and purpose of the department itself. Therefore, although the fundamental functions of the Department of Labor are not discussed further, the Bureau of Employment Security, which represents 87% of the department's estimated 1950 expenditures, is dealt with at some length.

Third, the very substantial reduction recommended in the total expenditure as compared with the present rate, has been produced in two ways: first, the transfer of the railroad retirement and unemployment tax receipts directly into the trust accounts instead of

entering this transfer as an expenditure. The present total of expenditure is improperly inflated by the procedure now followed. Second, an extensive transfer of social welfare and relief functions to the states has been recommended, together with a discontinuance of federal grants to the states for these purposes. The ability of the states to perform these services is clearly shown by the fact that they are now handling them. It is basic to the re-allocation of services and tax resources in the program offered here that the states be allowed a sufficient leeway in the levy of their own taxes to render unnecessary an elaborate array of federal grants, whether in large or small amounts. The grant system involves unneeded and expensive federal supervision and control, and its continuous expansion, under which federal monopolization of tax sources has forced ever greater state dependency upon the federal treasury, is carrying the nation steadily toward the socialist state.

As an illustration of the extent to which the re-allocation of tax sources proposed in this program would increase the ability of all states to provide for the welfare services recommended for transfer to them, there is presented, in Table XXXI, a comparison of the total welfare grants in the fiscal year 1949 and the saving to the citizens of each state in individual income tax under the proposed flat rate federal tax. Certain general preliminary comments regarding the construction of the table and its primary purpose here are in order.

First, there is no intention to suggest, through this table, that each state must have an income tax in order to assume the cost of the welfare and relief services to be transferred to it. The one and only point intended to be brought out in the table is that a reduction of the federal individual income tax to a total of \$9 billion and collection of this amount at a flat rate, would leave with the citizens of every state more, and in many instances far more, income than it would be necessary for the state to take, by some kind of taxation, to carry the additional welfare responsibilities to be assumed. The manner in which the states would increase their revenues for this purpose should be left entirely to their own determination.

Second, the table indicates, but as a rough approximation only,

the distribution of the proposed federal tax of \$9 billion of individual incomes at a flat rate. There is no satisfactory, simple and accurate means of calculating the distribution of such a tax on a state by state basis. In Table XXXI an indication of such allocation has been computed according to the proportionate distribution of the income tax withheld by employers in the fiscal year 1949. This portion of the income tax is not greatly different from a flat rate, and the withholding tables make allowance for personal credits and exemptions for dependents. It obviously does not allow in any way for incomes other than wages and salaries, and hence a certain distortion is produced as between predominantly agricultural and manufacturing states, respectively. Thus, the column headed "State share of a federal tax of \$9 billion" is to be regarded as indicative only, as is, also, the column headed "Income tax reduction from 1949 payment." There is no reason, however, to believe that the results obtained by making a distribution according to the income tax withholdings by states are so far from reality as to afford no indication whatever of the relative state shares in a total tax of \$9 billion imposed at a flat rate on all taxable income.

The reliability of the relative withholding tax collections as an indicator of the probable distribution of a tax on all individual incomes at a flat rate is confirmed by Treasury data showing the proportion of all income taxes collected by states. Notwithstanding that the Treasury distribution included both corporate and individual income taxes, the two series of percentages are very close together, state by state, with many instances of exact correspondence.

A further supporting indication is found in the relation of reported wages and salaries to total adjusted gross income. Such data, by states, are available for 1946. They establish that the withholding taxes are based on so large a sample of total income as to minimize the margin of error involved in the omission of other taxable income. For the nation, wages and salaries were 73.8 percent of adjusted gross income. In 24 states the percentage was within the bracket 73.8-78.8 percent, and in 8 others it was above 78.8 percent. In only 6 states was the percentage below 60 percent, and the lowest was 41.8 percent, which is still a substantial sample.

TABLE XXXI

INDIVIDUAL INCOME TAXES, 1949, THE RESPECTIVE STATE SHARES OF \$9 BILLION COLLECTED AT A FLAT RATE, AND FEDERAL WELFARE GRANTS, 1949

(Millions)

State	Income tax, 1949 ^a	State Share of \$9 billion ^b	Tax Reduction from 1949 Tax	Wel- fare Grants, 1949 ^c	Percent- age Grants of Tax Reduction
Alabama	\$114.6	\$57.6	\$57.0	\$26.4	46.3
Arizona	46.8	19.8	27.0	7.5	27.8
Arkansas	57.8	18.0	39.8	18.2	45.7
California	1,461.7	726.3	735.4	108.2	14.7
Colorado	126.7	56.7	70.0	20.2	28.9
Connecticut	302.4	166.5	135.9	10.4	7.7
Delaware	100.3	45.9	54.4	1.6	2.9
Florida	168.6	72.0	96.6	33.3	34.5
Georgia	159.3	81.0	78.3	29.8	38.1
Idaho	42.2	16.2	26.0	5.7	21.9
Illinois	1,441.8	847.8	594.0	64.5	10.9
Indiana	300.1	161.1	139.0	23.4	16.8
Iowa	209.5	72.9	136.6	21.2	15.5
Kansas	173.7	55.8	117.9	16.7	14.2
Kentucky	129.3	60.3	69.0	21.7	31.4
Louisiana	149.9	61.2	88.7	52.0	58.6
Maine	47.8	25.2	22.6	7.1	31.4
Maryland, Incl. D.C.	556.8	372.6	184.2	14.1	7.7
Massachusetts	570.5	331.2	239.3	46.6	19.4
Michigan	833.6	540.9	292.7	50.9	17.4
Minnesota	289.7	154.8	134.9	25.6	19.0
Mississippi	51.2	16.2	35.0	17.7	50.6
Missouri	406.1	230.4	175.7	51.6	29.4
Montana	46.7	14.4	32.3	6.2	19.2
Nebraska	135.7	54.9	80.8	10.9	13.4
Nevada	23.6	7.2	16.4	1.6	9.8
New Hampshire	34.8	18.9	15.9	3.9	24.5
New Jersey	500.0	298.8	201.2	19.2	9.5
New Mexico	35.6	11.7	23.9	6.3	26.4
New York	2,966.8	1,847.7	1,119.1	86.6	7.7
North Carolina	166.2	88.2	78.8	23.9	30.6
North Dakota	44.0	14.4	29.6	4.9	16.6
Ohio	975.3	596.7	378.6	57.5	15.2
Oklahoma	160.9	71.1	89.9	50.7	56.4
Oregon	161.3	76.5	84.8	12.4	14.6
Pennsylvania	1,324.6	755.1	569.5	61.8	10.9
Rhode Island	91.6	51.3	40.3	5.9	14.6

State	Income tax, 1949 ^a	State Share of \$9 billion ^b	Tax Reduction from 1949 Tax	Wel- fare Grants, 1949 ^c	Percent- age Grants of Tax Reduction
South Carolina	65.6	35.1	30.5	15.6	51.2
South Dakota	42.8	9.0	33.8	5.0	14.8
Tennessee	147.2	71.1	76.1	27.4	36.0
Texas	692.2	239.4	452.8	78.1	17.3
Utah	39.2	21.6	17.6	6.7	38.1
Vermont	19.0	9.0	10.0	3.3	33.0
Virginia	182.5	97.2	85.3	11.7	13.7
Washington	257.2	134.1	123.1	32.4	26.3
West Virginia	98.2	56.7	41.5	13.5	32.5
Wisconsin	311.2	182.7	128.5	22.8	17.7
Wyoming	23.5	6.3	17.2	2.5	14.5
Alaska	13.5	7.2	6.3	1.5	24.0
Hawaii	52.4	28.8	23.6	2.8	11.9
Totals ^d	\$16,352.0	\$9,000.0	\$7,352.0	\$1,249.4	17.1

a. See Table I, footnote (a) for explanation of adjustment of refunds estimated to be properly chargeable against the individual income tax collections of the fiscal year 1949. The distribution of this adjusted amount, namely \$1,700 million, by states, was made on the basis of data supplied by the Treasury Department pertaining to actual refunds, by states, for the calendar year 1949.

b. Allocated on the basis of withholding tax distribution for 1949, which was computed from Annual Report of Commissioner of Internal Revenue, 1949, Table I.

c. Welfare Grants, see Table XXXVIII.

d. Totals do not add because of rounding.

An inference that may be drawn from the proposed shift of the federal income tax from progressive rates to a flat rate is that this would benefit the high income states relatively more than the low income states. Corollary to this belief is the doctrine that progression must be retained in order that the high income states shall help the low income states.

These views are not sustained by the foregoing table. The test of relative advantage is not the absolute dollars of tax reduction, for the states now paying large amounts will get large amounts of reduction. Rather, the test is the degree of reduction below the 1949 tax. The following comparison of the relative savings in a group of high income states and a group of low income states illustrates the point:

PERCENTAGE OF INCOME TAX REDUCTION FROM 1949 TAX

States with high per capita income		States with low per capita income	
State	Percentage Reduction	State	Percentage Reduction
Connecticut	44.9	Arkansas	68.9
Illinois	41.2	Florida	57.3
Massachusetts	41.9	Kentucky	53.4
Michigan	35.1	Louisiana	59.2
New Jersey	40.2	Mississippi	68.4
New York	37.7	New Mexico	67.1
Ohio	38.8	Oklahoma	55.9
Rhode Island	44.0	Tennessee	51.7

From this comparison it would appear that the levy of federal income tax at a flat rate would benefit the low income states relatively more than it would the high income states. From the standpoint of the different regions, a flat tax rate would be an application of the principle of ability to pay.

Entirely apart from the slight distortion in the above method of apportioning the proposed new tax of \$9 billion at a flat rate, it is obvious that there would be far more income left in the pockets of the citizens of each state, by comparison with federal income taxes at present rates, than would be required to provide that state's share of federal welfare grants totalling \$1 billion. For the citizens of the country as a whole, there would be an overall advantage of some \$6 billion in income tax reduction, even after assuming on their own account the grants for welfare purposes now made by the federal government.

The discussion now turns to a consideration of the functions, expenditures, and proposed future status of the more important functions listed in Table XXX.

The Federal Security Agency.

The Federal Security Agency is the seat of social welfare programming in the nation and from it stem the purposes and trends of country-wide welfare expenditures. The growth of various programs can be traced in the ten years' history of this agency. On July 1, 1939, the Social Security Board, the United States Employment Service, the Public Health Service, the Office of Education, and the then existing Civilian Conservation Corps and National Youth Administration were integrated into one admin-

istrative unit. In 1946 the Children's Bureau was transferred from the Department of Labor, the Bureau of Vital Statistics from the Department of Commerce, and the responsibilities of the then independent Social Security Board and the Employee's Compensation Commission were placed under the authority of the Agency.

Since its establishment, the Federal Security Agency has spent upwards of \$750 million a year. Currently, it is doing business through some thirty offices and bureaus at an annual rate of well over a billion. The expenditures, appropriations, and recommendations for this agency are summarized in Table XXXII.

TABLE XXXII

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR THE FEDERAL SECURITY AGENCY

(Thousands)

Agency	Actual Expenditures		Appropriation,	Proposed,
	1948	1949	1950	195X
Social Security Administration	\$ 833,835	\$1,098,950	\$1,227,046	\$ 4,100
Public Health Service	109,961	138,283 ^a	200,331	100,000
Office of Education	33,640	33,462	34,133	1,500
Office of Vocational Rehabilitation	22,458	15,496	21,185	500
Bureau of Employees' Compensation	15,197	15,334	26,691	15,000
Food and Drug Administration	4,596	5,289	5,781	6,000
Freedman's Hospital	1,937	2,393	2,443	2,500
Howard University	2,217	2,286 ^b	8,054	3,000
St. Elizabeth's Hospital	1,656	2,993 ^c	5,438	2,000
Office of the Administrator	2,476	3,549	4,002	1,000
All other	392	405	440	300
Totals	\$1,028,365	\$1,318,440	\$1,535,544	\$135,900

a. Includes \$4,098,000 from General Services Administration.

b. Includes \$24,000 from General Services Administration.

c. Includes \$1,492,000 from General Services Administration.

As the above list of institutions and offices indicates, the Federal Security Agency has developed into a general supervisory authority in the field of public health and social welfare. The Hoover Commission reports recommended a new department of social security, education, and Indian affairs, and a separate independent office in which all civilian medical services would be united. A minority of the Commission favored a department of welfare which would combine all of these activities. The President's own preference, ex-

pressed in repeated recommendations, coincided with this minority proposal.

The question of the scope and organizational status of the agencies dealing with these matters should be determined by reference to the part which the federal government is to play henceforth in regard to them. Thus far it has operated in two major ways: one is research, stimulus to state and local agencies, and overall leadership in dealing with health and welfare problems. The other way is through grants-in-aid. The position taken here is that, in general, federal activity and responsibility should be limited to the first of these areas, and that the second should be abandoned. Assuming that the grants, even in the trivial amounts allowed to each state in the beginning, performed a valuable service in stimulating state and local authorities to a greater awareness of health and welfare problems, it is apparent today that this original service has been adequately performed and that there is no need to continue federal support in order to assure a continuance of state and local activity and concern.

The distribution of the Federal Security Agency expenditures between grants and other purposes is shown in Table XXXIII.

TABLE XXXIII

FEDERAL SECURITY AGENCY EXPENDITURES FOR GRANTS
AND OTHER PURPOSES, FISCAL YEARS 1948-1950
(Thousands)

Purpose	Fiscal Years		
	1948	1949	1950 ^a
Welfare	\$ 757,253	\$ 937,833	\$1,170,213
Health	58,666	70,818	142,300
Employment Security ^b	67,155	140,313	35,473
Education	31,693	31,277	31,858
Total Grants	\$ 914,767	\$1,180,241	\$1,379,844
Other Purposes	113,598	138,199	153,752
Total Expenditures	\$1,028,365	\$1,318,440	\$1,533,596
Percent, grants of total	89	90	90

a. Data for 1950 are appropriations.

b. The variations in the amounts for this purpose are caused by the shifting of certain services between the Agency and the Department of Labor.

These figures should be very illuminating to the citizens. They have been led to understand that the Federal Security Agency is

performing services of such scope and importance that it deserves elevation to the status of a government department. The fact is that 90 per cent of its activity, in terms of dollars paid out, consists in handing back to the states the money that has first been collected from the people in taxes. Once the illusory character of this kind of financial juggling is perceived and the grant system is eliminated, there would remain, as the only defensible and legitimate activities of the agency the services of research, stimulus, and leadership, and the operation of certain institutions. The amount recommended for the agency in 195X, namely \$135.9 million, would be ample for all of these purposes.

The details of the present and recommended expenditures, by major spending units of the agency, are presented in the following discussion.

Social Security Administration.

The Social Security Administration is the home of federal social planning. Its several bureaus influence the economic-welfare expenditures of the nation. It supervises unemployment compensation and operates the old age and survivors insurance program. Excluding the trust fund operations of the social insurances, the expenditures, appropriations, and recommendations for this agency are given in Table XXXIV.

TABLE XXXIV
SOCIAL SECURITY ADMINISTRATION
(Thousands)

Agency	Actual Expenditures		Appropriation, 1950	Proposed, 195X
	1948	1949		
Bureau of Employment Security	\$ 71,266	\$ 147,890	\$ 139,675 ^a	—
Federal Credit Unions	—	548	619	—
Old Age and Survivors Insurance ^b	700	3,274	3,604	\$4,000
Bureau of Public Assistance	733,139	922,163	1,059,350	—
Childrens' Bureau	24,757	24,523	23,541	—
Office of the Commissioner	3,972	551	258	100
Totals	\$ 833,835	\$ 1,098,949	\$ 1,227,047	\$4,100

a. The Bureau of Employment Security has been transferred again to the Department of Labor.

b. Expenditures from appropriated funds only, for payment of benefits to veterans of World War II.

Bureau of Employment Security.

Federal activity in this field began in 1907 with an information service in the Bureau of Immigration, and, during the first World War there were some 850 federally operated local employment offices throughout the country. But the real impetus to the present program began with the concurrent establishment in 1933 of 1) The Federal National Re-employment Service to recruit labor for emergency work projects, and 2) the United States Employment Service created in the Department of Labor by the Wagner-Peyser Act to administer a federal-state system of unemployment offices. But by the end of fiscal 1934 only eighteen states had set up cooperating services. Passage of the Social Security Act in 1935 corrected this, however, by an administrative requirement that "all unemployment compensation . . . be paid through public employment offices or such other agencies as the (Social Security) Board may approve." Since the Board approved no other agencies, every state had an employment office as soon as it had an unemployment compensation program; and that was rather quickly accomplished so that the state might be eligible for credit against the newly enacted federal tax on employers of eight or more. A basic tax of 3 percent of taxable payrolls was levied with the provision that an offset up to 2.7 percent would be allowed those states which collected a state unemployment tax to finance "approved plans" of unemployment compensation. The remaining .3 percent was to be retained by the federal government. This .3 percent, referred to as the "federal unemployment tax" is considered to finance the grants to the states for employment security administration.

When the Social Security Board established grants-in-aid for the maintenance of the state employment offices in 100 percent support of unemployment compensation administration, it meant that the state agencies were dealing with two separate federal offices. Therefore, in Reorganization Plan No. 1 of 1939, the United States Employment Service was transferred to the Bureau of Employment Security under the Social Security Board. In 1942, as a wartime measure, the USES and the state employment services were transferred to the War Manpower Commission. The states did not regain control of their own employment offices until 1946, but in 1945 when the Commission was abolished the USES was

returned to its original jurisdiction under the Department of Labor. It remained there until the Labor-Federal Security Agency Appropriation Act of 1949 removed it again to the Federal Security Agency. Reorganization Plan No. 2, effective August 20, 1949, transferred it once more to the Department of Labor.

The functions of this bureau are primarily to conduct the federal activities associated with the state employment security systems. Generally speaking, this means managing the federal grants-in-aid for the state administration of their unemployment compensation programs and their employment services. However, the bureau also reviews and promotes pertinent state legislation, promotes conformity of state programs to federal requirements for grants-in-aid, and in general endeavors to develop improved state procedures. The current fiscal picture for the functions now discharged by this bureau is given in the following tabulation and includes 1948 expenditures of \$70,092,000 for the USES prior to its transfer from the Department of Labor.

	(Thousands)		
	Actual 1948	Expenditures 1949	Appropriation 1950
Grants to the states	\$133,048	\$139,559	\$135,000 ^a
Unemployment compensation	(67,155) ^b	—	—
Employment offices	(65,893) ^c	—	—
Other expenditures	8,311 ^d	8,331	4,450
Totals	\$141,359	\$147,890	\$139,450

a. Public Law 141, 81st Congress, 1st Session authorizes expenditures through March 31, 1950, at an annual rate of \$150,000,000, and with the approval of the Federal Security Administrator and the Director of the Budget, at an annual rate of \$157,500,000, if necessary to meet increased costs of state administration.

b. Through the Federal Security Agency.

c. Through the Department of Labor.

d. Includes \$4,199,000 for the Department of Labor.

In an appraisal of federal activities which might be re-allocated to the states, employment security is an easy candidate for first place. Unemployment compensation and the employment services are state programs, state-legislated and state-administered. They were federally instigated and their administration is and has been federally financed; but they are essentially state functions.

It is true that these programs are of national significance. It was

indeed the nation-wide situation of unemployment in the mid-thirties which enabled the federal government to coerce the states, through a tax-credit mechanism, into establishing coordinated unemployment compensation and employment service programs. The emergency provided the grounds for promoting the systems initially. But now that they are on the statute books of 48 states and operate according to standards bearing the stamp of federal approval, and since the wartime excuse for federalization is past, there is no reason for continued federal supervision, controls and expenditures. In a sense the retention of .3 percent of the unemployment tax by the federal government and the grants-in-aid ostensibly financed thereby, are "survivals."

In discussing the financing of employment security administration, the Hoover Commission task force report on Public Welfare pointedly says,³

The basic question of public policy for Congress to determine is whether the national interest in employment security requires the federal government to provide adequate administration and control over state expenditures for employment security.

The task force refers to this as "the major issue in the present federal-state equilibrium of responsibility in employment security," and says further, more specifically, "Complete federalization or complete state responsibility is not in issue." It would seem, on the contrary, that exactly these alternatives were in issue, and the only essential issue. The compromise middle road, the present so-called federal-state system has outlived its needfulness. Now that the system is well under way, there are only two directions in which it can move, to ultimate centralization, or complete decentralization. The Federal Security Agency and the President have repeatedly suggested federalization. The President's Mid-Year Economic Report of 1949 carries recommendations which are a step in this direction. The states, on the other hand, despite these attempts, have succeeded in their fight to retain responsibility. In this deadlock it would seem that the issue is a clear cut question, and not merely a series of alternative methods of financing the administration of employment security.

³ Task Force Report on *Public Welfare*, p. 439; see also pp. 429-30.

The essential point is that the employment security programs are state programs, state-legislated and state-administered. They were initiated by federal action and their administration has been and is federally financed; but they are essentially state functions. The national interest would be fully served by retaining the formality of a federal tax, as a policing measure, but with complete offset against this tax of all amounts paid to the states. In this view, the federal levy would be purely nominal as long as the states retained their unemployment compensation systems and complied with certain federal regulations. The policing function, essentially a staff operation, could well be delegated to the Office of the Commissioner. In all other respects the system could and should be fully released to state authorities.

Complete state responsibility would require the federal government to give up the retention of collections under its .3 percent tax, and also, to accept no further amounts of state unemployment tax collections for holding in the accounts of the states in the federal unemployment trust fund. There is no particular need for federal management of these state reserve funds. The states could create their own trust funds to hold reserves from current collections and draw upon their present accounts in the federal trust fund for the payment of benefits. Only when accounts in the federal trust fund were thus depleted would the states begin to draw on their own reserves for payment of benefits. Also, freed of federal restrictions, any state which wished to operate its system on a pay-as-you-go rather than on a reserve basis, which is always somewhat tenuous, could do so.

Except for individual years and for individual states, collections of state unemployment taxes have exceeded benefit payments to such an extent that the federal unemployment trust fund now holds over \$7 billion to the credit of state accounts. On a cumulative basis, through 1947 from the inception of the program, total benefits paid have been only 40.9 percent of the employers' contributions collected. In individual states this ratio varies from extremes of about 20 percent to a little over 60 percent. The annual sum of the different state reserve accounts, that is, the cash income to the unemployment trust fund, has been used by the federal government, first during the war for general purposes, and more re-

cently for a reduction in the federal marketable debt. It is pointed out in Chapter 12 that under state management there could be acquired assets of other governmental units, and approved private securities, which would constitute a bona fide reserve. The result is never attainable, at either federal or state level, by holding only the obligations of the government responsible for the trust.

Revision of the Federal Unemployment Tax Act as suggested above and the discontinuance of federal grants to the states for employment security purposes would correct the "serious administrative problems" which stem, according to the working papers of the task force on federal-state relations, from the present system of divided control. It would eliminate the need for federal personnel and expenditures in this field thus reducing overall costs of the program. It would also strengthen the responsible role of state government. It is significant of the federally determined status of the states in this regard that the report of the task force on welfare says "the states *are permitted* to establish the variations in employer tax obligations, coverage, eligibility . . . benefits, etc."⁴ (Italics supplied.) Complete decentralization would also permit them to determine and control their own administrative costs, allotting less than .3 percent to administration when possible, thus avoiding not only the burdensome federal requirements, but also the inequity of what is essentially a subsidy from employers in some states to the relatively high cost of unemployment administration in other states. Each state could then decide for itself what was necessary for the proper and efficient administration of its system. As it is now, grants are allocated largely on the basis of what the Federal Security Administrator thinks is necessary and what he deems proper state compliance to federal requirements. The task force on welfare says that the crux of state criticism of federal control centers around this authority of the Administrator and the Social Security Administration, and that "responsibility for the matter of its exercise has deliberately been assumed. . . ."⁵

Although the Hoover Commission itself goes no further into the question of the Bureau of Employment Security than to recommend that it be transferred to the Department of Labor, the task

⁴ *Ibid.*, p. 429.

⁵ *Ibid.*, p. 431.

force reports on federal-state relations and public welfare both make specific suggestions. The former recommends:⁶

that the present national tax on employers . . . be made available to the states on some agreed formula basis, without accompanying stringent control over state administration, so that every state can finance the cost of administering this program. The present discretionary basis of apportionment should be eliminated.

The task force on public welfare, after some detailed discussion, recommends retaining the tax offset method of financing in order to insure state compliance with federal standards. However, it also makes a suggestion for financing the "deficit" states.⁷

If Congress should decide that it is more important to place financial responsibility for administration in the hands of the states than to maintain federal responsibilities . . . the federal government should retain some of the . . . tax for federal administrative expenses in . . . operating a loan . . . fund, and making flat grants sufficient to meet the minimum needs of the dozen states whose collections for administration do not meet administrative costs. . . . These conditions would permit raising the offset to perhaps 2.9, and segregating the . . . difference between 2.7 and 2.9 (in the trust funds) to be available for withdrawal by the states for administrative expenses.

This latter suggestion is a good example of taking away in the little print what was given in the big print. In the first place it is not placing financial responsibility in the hands of the states for the federal government to "segregate" .2 percent of the federal tax for withdrawal from the trust fund in lieu of retaining .3 percent for partial disbursement in grants-in-aid. In the second place the actual financial effect on the states would not be much different in the long run than permitting a fractional increase in the contribution rate for immediate diversion to administrative costs, or alternative reliance on general state funds as needed. For, when any state had withdrawn the total segregated in its account for administrative expenses, there would be no way — except for these alternative sources — for it to obtain any "deficit."

The recommendation here made, that complete responsibility be given the states, is not new. The Hearings on the Federal Security Agency Appropriation for 1950 point this up clearly:⁸

⁶ Task Force, Summary Report on *Federal-State Relations*, as reproduced by Tax Foundation, New York, p. 15.

⁷ Task Force Report on *Public Welfare*, pp. 445-6.

⁸ *Hearings before Subcommittee of the House Appropriations Committee*, p. 490.

Mr. Keefe. . . . this . . . has been discussed in the Ways and Means Committee time and again and it has been discussed in the interstate conference time and again . . . the proposal to wipe out this 3 percent tax completely and allow the states to collect their own money and run their own show . . . and allow the states to levy the tax sufficient to maintain the type of program they feel they ought to maintain. . . .

Mr. Scrivner. What is the objection to that?

Mr. Keefe. Well, that is a very hot question . . . legislation to accomplish that end . . . was offered in the last Congress. . . . In fact, I think the great majority of the members of the interstate conference favor that type of program to get out from under the pressure of this federal tax and control.

A significant comment about the Interstate Conference was made in the House Report on this appropriation bill. The Conference was established in 1938 to promote among the states consideration of their common problems in employment security programs. Its activities are financed from appropriations for grants to the states. The committee report says:⁹

that an appreciable amount of conference activity duplicates the duties and responsibilities assigned by the Congress to the Bureau of Employment Security and that this duplication should be eliminated. If this duplication were eliminated it would effect substantial savings without lessening the effectiveness of interstate cooperation.

Surely this is an open indication that the Conference, financed by state administrative funds, could be continued and the Bureau of Employment Security discontinued. The savings would indeed be substantial, and the state employment security systems would be on their own.

The activities carried on by this bureau beyond those in connection with the state programs involve studies and research on various employment and labor statistics. These are appropriate functions to be transferred to the Bureau of Labor Statistics. This is recommended by the task force on public welfare,¹⁰ which goes so far as to say that the Employment Service "should not be relied upon to collect general employment statistics," also that, "in the occupational outlook field at the federal level the Bureau of Labor Statistics should be recognized as having primary jurisdiction," and specifically that "the special nation-wide industry studies" of the

⁹ House of Representatives *Report No. 228*, 81st Congress, 1st Session, p. 27.

¹⁰ *Op. cit.*, p. 402.

Employment Service should be transferred. The studies of local labor markets which the Service conducts, the task force points out, can be developed from the normal operating reports of the state agencies. Since that is so, they can also be maintained, and more fittingly so, by the state agencies.

In sum, the Bureau of Employment Security can with comparative ease be eliminated from the Federal Security Agency.

Bureau of Federal Credit Unions.

The Federal Credit Union Act, effective June 26, 1934, was enacted during a general economic situation which no longer exists, to serve needs which, if they still continue at all, have long since been met by other means. For example, the prime purpose of the Act was "to establish a further market for securities of the United States." Furthermore, its activities have been at times in conflict with other policies such as the restriction of credit, installment buying and the like. These credit unions are cooperative associations organized to provide for people of small means a source of credit for provident or productive purposes thereby, as the original act says, "helping to stabilize the credit structure of the United States." The fact that the Bureau has been transferred from the Farm Credit Administration to the Federal Deposit Insurance Corporation, and then to the Federal Security Agency indicates that question has existed as to its continuing function and appropriateness.

Since 1934 federal credit unions have made 8,300,000 loans totalling \$1,040 million. Their volume of business has grown steadily. There are now 4,100 federally chartered unions with over 1,500,000 members and \$250 million in assets. They make 950,000 loans a year totalling \$200 million. The budget estimate for operations of the bureau in 1950 is \$618,500, but only \$200,000 of this is to be appropriated from general funds, and no more than \$418,500 from fees collected from the unions for federal charter and supervision. Since the fees expected to be collected from the unions in 1950 are only \$217,000, the difference is authorized for use from surplus fees accumulated through past years. This surplus will not be available in future years, and, as it is used, administrative costs will require greater federal subsidy. There are legal

maximum charges for charter but the fees charged for examination are at the discretion of the administrator. In this regard the report of the House Committee on Appropriations for the Federal Security Agency says,¹¹

The committee urges . . . constant attention to the matter of examination fees charged to the end that actual cost . . . be recovered to the fullest extent possible. The Agency might well consider recommending changes in basic legislation to increase the maximums for chartering and supervision, and examination. The condition of the Federal Treasury today is a far cry from what it was in 1934 when the fee provisions were adopted.

As a matter of fact, the condition of the general economy is a far cry from what it was in 1934. And if the fee provisions are to be reviewed in the light of current circumstances, it would be appropriate to review the purpose and need of this entire function under today's conditions. There are in all 9,500 credit unions in the country, with 3.5 million members and total assets of about \$600 million. There are over 5,000 state credit unions. Thus, the federally chartered unions represent only about 40 per cent of the entire business of this type. The question naturally arises: Is even that much federal activity necessary? Or any? Is this another unnecessary survival of the depression? If roughly 60 percent of the country's business of this type can be done without being subsidized by the federal government, what need is there for the central government to be in the business, and how great a competitive threat and deterrent is this federal activity to the extension and vitality of voluntary enterprise in this field?

The position taken here is that the Bureau of Federal Credit Unions should be dissolved and its activities terminated as rapidly as possible. The absence of any comment on this bureau by the Hoover Commission is testimony to the fact that this function is so minute as to be dispensable, and on this score alone it can be deemed an unnecessary and inappropriate federal undertaking.

Bureau of Old Age and Survivors Insurance.

This bureau administers the national system of old age and survivors insurance established by Title II of the Social Security Act. It keeps the records of workers' taxable earnings, handles

¹¹ *Op. cit.*, p. 28.

claims for benefits, and makes payments to beneficiaries. Benefit payments are paid out of the trust fund in which the Treasury holds all collections of the 1½ percent tax levied on taxable earnings or payroll of employees and employers respectively. The management and significance of the trust fund are discussed in Chapter 12. This section is confined to the expenses and administration of the bureau itself, and general program policy.

With a single exception all operating expenses are consolidated in an authorization for payment of salaries and expenses from the trust fund. The exception is the cost borne by the federal government for limited extension of survivors insurance protection under Section 210 of the Social Security Amendments of 1946. Retirement benefits are not included. Benefits under this section are not available if the individual died in active service or if discharge from service occurs after four years and a day following the termination of World War II. Nor are these benefits available if a Veterans Administration pension or compensation is payable on the basis of death. These are limited benefits for the survivors of individuals who were in active service within the period from September 16, 1940 to the termination of World War II, and who, after 90 days service or because of a service-connected disability, die within three years of leaving the service. The purpose is to extend certain benefits of OASI coverage to servicemen who lost or were prevented from obtaining insured status because of the war.

The financing of this special provision is from general funds, and not from the trust fund. These are the figures shown in Table XXXIV, and represent the only general fund appropriations for old age and survivors insurance. They are appropriations for benefit payments only. In 1947, the first full calendar year of operation, payments were made with respect to 19,700 veterans; and by the end of the year 14,600 dependents of deceased veterans were receiving monthly benefits because of Section 210. This special program is new and administrative expenses are not, as yet, clearly segregated in the budget estimates.

Funds for the general administrative expenses of the bureau, as well as for program benefits, are also excluded from Table XXXIV, since these are transfers from the trust fund and not

general fund appropriations. Such transfers were \$35 million in 1948, \$40 million in 1949, and are estimated at over \$43 million for 1950. The transfers do not reflect actual expenses for administration, however, due to various bookkeeping adjustments. Actual administrative expenses, with selected related data are given in Table XXXV.

TABLE XXXV

SELECTED DATA, OLD AGE AND SURVIVORS INSURANCE
(Thousands)

Calendar Year	Trust Fund Receipts ^a	Number of Monthly Benefits ^b	Total Benefit Payments	Administration Expenses
1940	\$ 607,004	222	\$ 35,354	\$26,203
1942	1,012,490	598	130,675	27,898
1944	1,315,680	955	208,972	29,201
1946	1,295,398	1,642	378,104	39,739
1948	1,687,820	2,315	556,174	51,277
1949	1,669,975	2,743	667,164	54,265

Source: Social Security Administration, 1947 *Yearbook*, p. 12; *Social Security Bulletins*, February 1949, pp. 27, 29, and March 1950, pp. 21, 22.

a. Equivalent to tax contributions except 1948 and 1949 include appropriation for benefits under Section 210.

b. Current at end of year.

It is important to note the long-term relative cost of administering the program rather than the current ratio of expenses to either benefit payments or tax-contributions paid. The ratio between administrative costs and benefits paid in 1940, an early year in the program's operation, was necessarily abnormal. Current operations are in greater volume, however, and are thus growing up to their costs. Such expenditure now represents activity in regard to some 43 million insured workers, out of roughly 50 million workers with wage credits. Claims run about 900,000 a year. The chief element in the cost of administration is the work of recording wages and determining average earnings during a worker's employment in covered industry in order to establish eligibility for benefits. The record of wages requires an exact account of the earnings of each covered worker. The bureau says¹² that there are about 190,000,000 information items reported each year. Employers bear most of this burden by the reporting process,

¹² *Hearings on Federal Security Agency, op. cit.*, pp. 574-5.

but 6 per cent of the items are incorrectly reported, thus raising administrative costs. The bureau estimates that it costs three cents to process a wage item correctly reported, and 23 cents more to identify and post properly an item incorrectly reported.

As the program matures, and it is now nowhere near its full growth, the ratio between expenses and benefits or collections will tend to find a somewhat constant level. But the absolute cost will increase considerably. Whereas benefits under present legislation now total only a half billion dollars it is conservatively estimated that they will increase to about \$2.5 billion by 1970, and to \$5 billion in the year 2000; the high cost estimates reach almost \$8.5 billion for 2000.¹³ As the program matures there will, of course, be an increasing proportion of insured workers among those aged 65 and over. But the aged population itself is becoming larger. Persons 65 and over were 7.2 percent of the population in 1945, but are expected to be 10.7 percent of the population in 1975. Therefore an increasing portion of the population will live to be 65 and to be insured. Thus it has been estimated that under present coverage, 74-84 percent of men attaining age 65 in 2000 will be insured, and also, by that year, 74-84 percent of men age 65 and over will be insured. Percentages for women are roughly half those for men and a point of stabilization does not occur even by 2000.

The reason for reviewing these details is to demonstrate that as long as the program is growing toward stabilization, administrative costs will rise and may bear an unrealistic relationship to benefit payments. As the Hoover Commission Report on Social Security says¹⁴, "the real burden of administrative cost will become evident only when approximately the same number of persons is being added and subtracted each year."

This stabilization point will be pushed even further ahead if new provisions are added to the system and if changes in basic requirements are made such as increasing the limit on taxable wages. New legislation increasing benefits would necessitate a refiguring of payments now in force, new authorizations, etc., a

¹³ Advisory Council on Social Security, *Old Age and Survivors Insurance*, a report to the Senate Committee on Finance, 1948; p. 55.

¹⁴ p. 22.

tremendous additional administrative responsibility. Under a greatly extended program, such as proposed by the Advisory Council on Social Security, by year 2000 administrative costs could attain a level of almost \$350 million. In fact, the administrative cost of a wage-based benefit is so great that the Hoover Commission task force report on welfare says¹⁵:

A question exists as to whether the social and economic advantages of a relationship between benefits and average earnings is sufficient to warrant the costs of administration and the difficulties of adjusting to meet changes in wages and prices.

But essentially the main question is not one of administrative costs, nor even of the fiscal significance of trust fund operations. (Chapter 12.) It is one of basic public policy. As long as administrative expenses and all benefit payments come out of the trust fund, the system supports itself and there is no question of direct government expenditure. It is not yet the budgetary problem that it would be if the taxes collected no longer currently financed the system, and if an appropriation from general funds, already provided for in the law, were to be made. It is in regard to this eventuality, that questions of public and fiscal policy would arise. The people are not generally aware of this potential "extra" cost. They have been sold on the notion that the payroll taxes will cover everything, even the new benefits and provisions being constantly promoted by the administration. They are benefit-conscious, but not cost-conscious. In the ultimate sense, the relationship of benefits and full costs is a matter for the people to decide. Their ignorance on the point may be politically expedient for some, but it is fundamentally and democratically unsound. The Hoover Commission task force report on welfare points this up as follows:¹⁶

... ultimate costs of old age and survivors insurance (will have) a future magnitude so great that they may have a profound effect on the economic and social system. . . . The question should be raised as to whether in a democracy the government should not present to the people in clear and simple form an analysis of all the problems involved and of their ultimate social and economic implications. The system has its benefits and its costs, and the people should decide whether the benefits are worth the cost.

¹⁵ *Op. cit.*, p. 475.

¹⁶ *Ibid.*, p. 489.

And the Hoover Commission itself, in referring to cost burden, says¹⁷

All these problems, and others, raise the question of Congressional examination of the whole subject. Some entirely new system may be necessary if we are to provide adequate protection against the hazards of old age for the American people.

The Hoover Commission thereafter states that a complete review such as recommended by the Board of Trustees of the Federal Old Age and Survivors Insurance Trust Fund, should be made, covering benefit formula, coverage, scope of protection and financial policy. Emphasis is given this point by the task force on welfare, with whose comment we concur:¹⁸

The need for a thoroughgoing, comprehensive review is indeed so great that it seems as if no sound conclusions as to organization and procedures can be reached until substantive issues of policy have been reconsidered and redefined. . . .

Bureau of Public Assistance.

It cost less annually to run the entire federal government before World War I than it will for the 1949 activities of the Bureau of Public Assistance. This bureau administers grants to the states for old age assistance, aid to the blind, and aid to dependent children, which were established by the Social Security Act. It approves, reviews and promotes the operation of state plans for administering the assistances, and it collects and publishes various data on these programs.

The federal government became active in the field of relief through the Federal Emergency Relief Administration at a time of national stress and because of the essential unpreparedness and inability of states and localities to meet the needs of the unemployed. Local revenues had declined, state reserves were used up, both state and local debt had risen measureably, and by contrast, the federal government was in a much superior position. It undertook participation in this state and local function of relief on a rescue basis. In speaking to the relief administrators on

¹⁷ *Op. cit.*, p. 22.

¹⁸ *Op. cit.*, p. 465.

June 14, 1933, President Roosevelt emphasized this as well as the traditional governmental jurisdiction of public welfare:¹⁹

The first responsibility of taking care of people out of work who are lacking housing, clothing, or food — the first charge is upon the locality; then, if the locality has done everything that it possibly can do, it is the duty of the State to step in and do all the State can possibly do; and, when the State can do no more, then it becomes the obligation of the Federal Government.

At the time, Mr. Roosevelt said that this principle was "just as sound today as it was last year." And it is still just as sound today as it was in 1932. But it has had little application since, for that year marked the beginning of the decline of local, and the growth of federal, responsibility for individual and family economic welfare. This change can best be traced by percentages showing the distribution of funds expended by different levels of government for all public assistance:

DISTRIBUTIVE SHARE OF FUNDS
(Percentages)

Calendar Year	Federal	State	Local
1930	—	8.7	91.3
1932	17.5	21.9	60.6
1934	64.8	14.4	20.8
1936	13.5	51.3	35.2
1938	22.2	50.3	27.5
1940	28.8	46.9	24.3
1942	38.8	43.2	18.0
1948	43.9	45.5	10.6

Source: Social Security Administration, the 1941 and 1942 *Yearbooks*, and "Source of Funds . . ." releases for 1943 and 1948.

In the above tabulation, the federal data represent Reconstruction Finance Corporation loans for state relief in 1932 and Federal Emergency Relief work projects until 1936; from then on, they represent grants to the states for the special assistances. The last column shows somewhat dramatically the weaning of the localities from a ninety to a ten percent participation. Local financing is almost wholly for general relief, and the proportionate decrease in local funds reflects not only the improved economic

¹⁹ The Public Papers and Addresses of Franklin D. Roosevelt, 1933 *The Year of Crisis*, Random House, New York, 1938, p. 238.

conditions of later years, but the increasing eligibility for special assistances as requirements for them became more lenient.

The assumption of responsibility by the central government can be illustrated by the broadening of the participation basis for old age assistance. Parallel changes were also made for aid to the blind and aid to dependent children. Under the act of 1935, the central government matched state expenditures, 50-50, up to a maximum of \$30 per month per recipient. The 1939 amendments raised this maximum to \$40. The 1946 amendments altered the formula to two-thirds of the first \$15 and one-half of the remainder up to \$45. The 1948 amendments further increased the federal share to three-fourths of the first \$20 and half the remainder up to \$50. The result in 1948 was this: federal grants were 57.4 percent of the nation-wide expenditures for old age assistance. Naturally this ratio varies in individual states, but in a few it represents about 75 percent of the average payment.

The welfare function is thus in fact no longer predominantly local; nor is it a sufficiently strong state function. A three-level, vertical integration of activities, with heavy federal financial participation and correspondingly heavy control of standards, has in effect put the reins in the hands of the central government. The basis of expanding service and growing costs is the development and popularization of the concept of public responsibility for individual security. And in this, "public" actually means "federal," for the initiation of existing "privilege" programs has been federal, even as their advancement now is primarily federal. The result has been rising standards with increasing service and benefit, much of which was worthwhile. But it has also meant federal acceleration of costs, all of which has not been necessary.

The war diminished unemployment and somewhat reduced welfare caseloads. But it lessened only the prominence, not the bulk of expenditures. For example, in 1938 federal, state and local governments spent \$985 million for public assistance. The same level of expenditure existed through the war; in both 1941 and 1945, with only a slight dip in between, the country-wide cost was \$990 million. With postwar employment adjustments, with ever-widening eligibility requirements, with constantly increasing average case payments, three-level governmental expendi-

tures were \$1,737 million in 1948. This is the peak figure for the history of public assistance as such. And the trend is upward. In 1949 the federal government alone actually spent \$921 million for special assistance grants — almost as much as the 1938 total for all levels of government. It is not questioned that the federal government should have rescued the nation at a time of real emergency; but it is neither necessary nor appropriate for it to continue being the main support of those in chronically poor circumstances.

The sum of the amounts received by individual states in 1949 in public assistance grants is shown in Table XXXVIII. The current fiscal data for the Bureau of Public Assistance are as follows:

	(Thousands)		Appropriations
	Actual Expenditures ^a		
	1948	1949	1950
Grants to states	\$731,989	\$920,814	\$1,058,000
Salaries and expenses	1,151	1,349	1,350
Total	\$733,139	\$922,163	\$1,059,350

a. Expenditure data in the President's Budget do not always correspond with those published in the Report of the Secretary of the Treasury. These figures therefore differ from those in Table XXXVIII.

The position taken here is that the one-time justification for federal grants to the states for public assistance no longer exists. The states and localities are not in the distressed financial condition they then were, and the federal government is no longer in as good condition as it then was. Administrative machinery at both state and local levels has been highly developed and can operate without federal supervision. With the fiscal resources herein recommended for state and local use, it will be unnecessary for the federal government to support in any degree the public assistance programs of the states.

The growth of federal activity in this field and the strength of its entrenchment now can be more directly related to politics than to economics. And if the trend continues as it is, the first result will be political downfall in the form of complete federalization. It would seem rather significant that funds for public assistance are almost always approved as requested, and that there is seldom a voice raised in Congress against continuing high

subsidy of these programs. Even the Hoover Commission, in both its reports on social security and on federal-state relations, handled the subject with very light touch.

On the other hand the task force reports on both these subjects were outspoken. The federal-state relations report says:²⁰

In listing these (welfare) functions as being those in which the states should have direct and primary control, the Committee recognizes the existence of a national interest in each and every one of them. . . . This national interest in these functions does not mean, however, that it is therefore desirable that the national government control and try itself to perform these functions throughout the length and breadth of the land. It is important to localize the primary control as much as possible, and to place the responsibility definitely on one level of government. That level, we believe, should be the states, which may redelegate to their local units such parts of each function as they deem wise.

The section of the welfare task force report which deals with public assistance was prepared by Dr. Lewis Meriam of Brookings Institution. He faced squarely up to this whole question of policy, and his points are so lucid as to merit quotation at length:²¹

It may be contended that shifting a burden from the National Government to the States would not have any real effect on the over-all costs of Government. Four points deserve consideration in this connection: (1) The greater the distance between the spending agencies of Government and the people who have power to control them, the less effective are the brakes; (2) an opinion has gained wide acceptance that the resources of the National Government are inexhaustible; many people see no relationship between heavy Government expenditures, high taxes, and high prices; (3) as compared with most State and local governments, but not all, the Federal Government has high salary scales, related to high costs, of living in metropolitan centers and control from Washington involves much travel; and (4) detailed Federal supervision results in substantial overhead costs.

More important than any of these matters lies the issue of the future of the federal form of government in the United States. . . .

If a highly centralized National Government is feared lest it get beyond the control of the people, the Congress will give consideration in the field of public assistance to the abandonment of categories such as old-age assistance, aid to dependent children, and aid to the needy blind. It will first explore the possibilities of making more revenues available to the States by reserving for them certain sources of taxation. . . . If national grants-in-aid for public assistance remain necessary — as they may . . . for the relief of the poorest States — it will make block grants . . . leaving the States a considerable measure of discretion. . . .

²⁰ *Op. cit.*, p. 8.

²¹ *Op. cit.*, pp. 529-30.

No better summation of the values involved is needed. But the position taken in this study can be made more explicit. Titles I, IV and X of the Social Security Act should be repealed, and the states should be left to administer and finance their own welfare programs. The way for the federal government to assist the states in these programs is not through grants-in-aid but through an equitable distribution of tax sources. In the overall re-allocation of tax resources suggested earlier in this study, there is ample room for the assumption of complete state financial responsibility. Those states which wish to establish or continue state-local administration and wish to support these programs on an intra-state equalization basis will have the fiscal capacity to do so. Decision and control will rest, as appropriately it should, with the state legislatures, and not with the Congress.

Children's Bureau.

Creation of the Children's Bureau was recommended in 1909 by Theodore Roosevelt's historic White House Conference on the Care of Dependent Children. In 1912 the Bureau was created "to investigate and report upon all matters pertaining to the welfare of children and child life among all classes of our people," and especially "infant mortality, the birthrate, orphanage, juvenile courts and desertion, dangerous occupations, accidents and diseases of children, employment and legislation affecting children . . ."

History of the bureau can be traced in three general areas of activity. First, at its inception great impetus was given the establishment of state systems of mothers' aid, the prime concern of the 1909 White House Conference having been the need of children to be cared for in their own homes. This aim culminated in the federal-state program for aid to dependent children, established by the Social Security Act. The second area of concern was child labor, and the bureau conducted all federal activities in this regard until 1946, when, without its Industrial Division, it was transferred to the Federal Security Agency. The third field of activity, and the only one now remaining as a major bureau function, involves child welfare and maternal and child health services.

The work of the bureau in these matters was augmented by three grants-in-aid programs of the Social Security Act. These were designed to enable the states to improve services a) for promoting the health of mothers and children, b) for locating and providing treatment and care for crippled children, and c) for the protection and care of homeless, dependent and neglected children, and children in danger of becoming delinquent. In 1946, bureau funds were increased to allow for temporary foster-home care, homemaker services, and certain care for some unmarried mothers.

The budgets for 1950 and 1951 combined these grants into one total, recommending the sum of \$22 million for grants, in the bureau aggregate of \$23.5 million. As reported by the Treasury, the amount expended in the past few years for these specific grants to the states are as follows:

	(Thousands)			
	1946	1947	1948	1949
Maternal and Child Health	\$ 5,935	\$10,672	\$10,564	\$10,703
Crippled Children	4,059	7,413	7,423	7,929
Child Welfare Services	1,278	2,010	3,357	3,563
Totals	\$11,272	\$20,095	\$21,344	\$22,195

In general it can be said that the present trend of bureau activities, especially in its studies and research, is toward development in the health field. For example, the Children's Bureau spent 10¢ of every public health dollar expended in 1948 by federal civilian agencies; and of the dollar for state aid, the Children's Bureau provided 25¢, the Public Health Service 71¢, and 4¢ came from the Dept. of Agriculture. Further indication of the bureau's emphasis on health matters are its growing publications in this field. One of the newest publications advertised by the bureau is *The Premature Infant: A Manual for Physicians*. The value of the book is not in question, but the need for the federal government to produce it, is. The bureau requested 10 additional positions in its 1950 budget to undertake a series of fundamental studies on factors and practices of child-bearing and infancy in a selected community. The Committee on Appropria-

tions thoughtfully disapproved this. The Federal Security Agency itself recommends that the states give priority of programming to the field of health and medical care under the federal grants. The overall direction of endeavor is all too clear in the following statement:²²

No state has a well-rounded, well-developed, and comprehensive program that will provide all the health, medical, and welfare services needed by all children.

The Hoover Commission task force on welfare pointed out that the bureau presented difficulty for the reorganization because of its multifunctional overlapping in the fields of health, education and welfare. In fact, it recommended that the health grant-in-aid program of the bureau be transferred to the Public Health Service.²³ And the Hoover Commission itself recommends that the bureau could function more effectively in a staff capacity concentrating on research, planning, and promotion, and that it be divested of grant functions: "The decision as to who should take over these grants can be made at the proper time . . ."²⁴

Decision on this particular question can be made following the general recommendations of this study. The purposes of these grants can be carried out by the states themselves with the tax resources here proposed for their use. In the aggregate, the \$22 million requested for 1950 for Children's Bureau grants to the states is comparatively insignificant; and the amounts actually received by individual states in 1949 ranged from a low of \$89,000 in Wyoming to \$1,037,000 in Texas. (See Table XXXVIII.)

It is thus proposed that 1) these grant programs be dispensed with, and 2) all matters of research related to maternal and child health, etc., be transferred to the Public Health Service.

In summary, the Children's Bureau, as such, may be liquidated. Naturally, some case can be made for the continuation and strengthening of practically any service ever begun by government. But when the historical justification for its establishment no longer exists, when state services have been proven by operation, and

²² *Social Security Bulletin*, February 1949, p. 9.

²³ *Op. cit.*, p. 66.

²⁴ *Op. cit.*, p. 17.

when the elimination of non-essential federal functions is imperative — there is no case at all for the continuation of this Bureau.

Office of the Commissioner.

This office has been responsible for overall direction, planning and coordination of the work of the various bureaus in the Social Security Administration. Its research and promotion activities will be sharply curtailed with the discontinuance of grants-in-aid now made under its jurisdiction and the consequent elimination of the bureaus involved. Therefore it is felt that expenditures of \$100,000 or so will provide all the research and promotion which should be undertaken by the central government in the field of social security.

Public Health Service.

In 1948 the Public Health Service celebrated its 150th anniversary. It is one of the oldest federal services, having been started in 1798 to provide medical and hospital care for American seamen. Beyond this, the concerns of its first hundred years were quarantine and control of communicable diseases. It was not until 1912 that research authority was expanded to include other conditions. In 1917 health studies and demonstration work began in rural communities. Funds for these purposes were the first to be spent on health in active cooperation with state and local governments. In 1918 the Venereal Disease Division was established, with funds to aid the states, but this work was later discontinued — not to be revived until the mid-thirties. At that time the Social Security Act established the pattern for the grant-in-aid programs now administered by the Service. The real growth and extension of the service, however, came after its transfer in 1939 from the Treasury to the Federal Security Agency. In this decade almost each year has produced legislation increasing program functions or authorizing new grants-in-aid.

The variety and purposes of the Service's full program may be seen in the following table of expenditures, appropriations and recommendations. Since the budget data for the Service are not organized by bureau or division, the particular classification shown in Table XXXVI represents items combined according to general area of service.

TABLE XXXVI
PUBLIC HEALTH SERVICE
(Thousands)

Agency	Actual Expenditures		Appropriation,	Proposed,
	1948	1949	1950	195X
Control of Venereal Disease	\$ 16,801	\$ 17,430	\$ 16,000	\$ 8,000
Control of Tuberculosis	7,867	8,890	9,550	3,000
General Assistance to States	14,126	13,919	16,600	—
Control of Communicable Diseases	7,667	7,698	7,350	7,000
Hospital Construction	2,038	10,096	40,000 ^a	—
Hospitals and Medical Care	19,639	24,380	25,700	25,000
Mental Health Activities	3,776	7,907	11,612	8,000
Foreign Quarantine	2,324	2,820	3,085	3,000
The National Institutes	14,901	26,182	42,586	36,000
Dental Health Activities	—	—	1,880	2,000
Construction of Research Facilities	3	19	17,100	—
Water Pollution Control	—	—	2,200	1,000
Salaries and Expenses	3,313	11,442	5,900	6,000
All other	17,506	3,952	1,430	1,000
Totals	\$109,961	\$134,184	\$200,331	\$100,000

a. In addition, contract authorizations of \$150,000,000 for hospital construction, and \$12,900,000 for construction of research facilities.

All activities in these various areas of service are conducted by four major administrative bureaus. These are as follows:

1. The Office of the Surgeon General conducts the internal management of the Service, and maintains the National Office of Vital Statistics and the Division of Sanitary Engineering. The latter administers the Water Pollution Control Act of 1948.

2. The Bureau of Medical Services operates the marine hospitals and the National Leprosarium, administers the National Mental Health Act of 1946 with its grants to the states, and maintains the Division of Federal Employee Health which organizes or operates preventive health programs for federal employees.

3. The Bureau of States Services is generally responsible for the federal-state programs. The Division of States Relations administers grants for general assistance to the states in the organization and development of health departments at state and local levels, and conducts demonstrations of new public health methods. The Divisions of Venereal Disease Control and Tuberculosis Control administer grants to the states for these purposes, and operate certain diagnostic and treatment programs in these

fields. The Division of Hospital Facilities administers the Hospital Survey and Construction Act of 1946 with its federal grants approximating one-third of the construction cost of approved projects. Other functions of this Bureau include studies in industrial hygiene, activities regarding control of communicable diseases, and promotion work in public health nursing and education.

4. The National Institutes of Cancer, Heart, and Health are institutions concentrating on research in cancer, heart, mental health, dental research, and in certain biologic fields. The institutes administer research grants to states and to non-profit institutions for special research, fellowships and technical equipment.

The so-called regular grants to states which are the bulk of the grants made by the Service are allocated by the Bureau of State Services. In total the public health grants are nowhere near so large a part of the whole program of the Service as they are of the Social Security Administration's program. The balance between administering grants to the states, and conducting research, developing standards and methods, promotion, and education is vastly different in these two branches of the Federal Security Agency. The amounts of Public Health Service grants to the states and territories, as expended in 1948 and as appropriations for 1950, are given below. Individual state totals of the regular grants, are shown for 1949 in Table XXXVIII.

Program	(Thousands)		
	1948	1949	1950 ^b
Regular grants : ^a			
Venereal disease	\$12,608	\$13,138	\$13,095
Tuberculosis	6,688	6,786	6,790
Assistance to states	11,173	11,213	14,200
Mental health	1,653	2,924	3,550
Hospital construction	957	10,550	40,000
Other : ^b			
Cancer	2,824	3,329	4,500
Heart ^c	—	—	2,000
Water pollution ^d	—	—	1,000
Totals	<u>\$35,903</u>	<u>\$47,940</u>	<u>\$85,135</u>

a. Expenditures for regular grants in 1948 and 1949 from Annual Reports of the Secretary of the Treasury.

b. Other grants, and appropriations for 1950 from the President's Budgets.

c. National Heart Act of June 16, 1948.

d. Water Pollution Control Act of June 30, 1948.

In the case of the Hospital Survey and Construction Act, the above figures are not at all indicative of the scope of federal commitments. The 1948 figure comprises \$565,140 for hospital survey and planning by the states, and only \$392,182 for actual construction; this was the first year construction funds were made available. In 1948 Congress introduced the mechanism of contractual authority into the operation of this program, so that an annual contract authorization of \$75,000,000 has since been made. The \$15 million appropriated for 1950 is merely for partial liquidation of prior contract authorizations. Under the original legislation, total federal expenditures would not exceed \$378 million, and no authorizations for further commitments may be made after fiscal year 1951. When these term commitments are fulfilled, no further subsidy for the construction of state, local or non-profit medical facilities should be made.

Other regular grants administered by the service may be easily discontinued. Amounts in the aggregate are comparatively minor, and individual state receipts under any or all of them are relatively insignificant. The tax resources here proposed for use by the states will more than allow for adequate financing of state and local health services. One of the assets in regard to this proposal is the clear-cut line of responsibility that has been maintained between the Service and the state health departments. This, the Hoover Commission task force on federal-state relations says, is one of the reasons there is relatively little friction between the two levels of government on these particular programs.²⁵

State administrative responsibility is unquestioned for all public health work within the state. Decisions of state health directors are final so long as they stay within the general purpose of the national law and the rather broad regulations of the national supervising agencies. *The Public Health Service has been extremely careful not to usurp state authority.* (Italics supplied)

Actual effort to preserve state responsibility in a federal grant program is unusual as well as commendable, otherwise this task force would have found it no cause for emphasis. And it should all the more readily lead to complete state emancipation. Public

²⁵ Mimeo appendix to Report on *Federal-State Relations*, p. 24.

health as well as public welfare and education, are areas which the task force considered²⁶

... fundamentally duties of the several states (although) the national government should and can co-operate in many ways. By a proper system of taxation, funds may be made more available for state purposes. . . . In the field of public health, assistance should be given by research and steps taken in preventing spread of communicable diseases.

In regard to research grants and fellowships, no position is here taken. Certainly such grants should be held to a minimum. There may be justification for questioning the need as well as the propriety of federal fellowships to individuals, and expansion in this area should certainly not be pushed.

A program which could very well die in its infancy is the Employees' Health Act of 1946. This is permissive legislation ostensibly to enable department and agencies, on consultation with the Public Health Service, to establish health programs for their employees in order to determine fitness for duty, to treat emergency cases for referral to private physicians, and to establish preventive programs. However, the extensive surveying of employee needs and community facilities made throughout the country by the Public Health Service in the interests of "advising" other government units, has led to serious questioning from the Subcommittee on Labor Department and Federal Security Appropriations. Recommendations to establish medical facilities or centers for diagnosis have been the crux of the issue. For example, the Service recommended a \$637,000 center to "serve all the Federal employees activities in Chicago."²⁷

Mr. Keefe. What treatment do they give them at the diagnostic center?

Dr. Cronin. Absolutely no treatment at all.

Mr. Keefe. Then why couldn't this individual employee — take in my town or in the doctor's (Dr. Hedrick) town, or any town of 40,000 or 50,000 or 25,000 all over the country, where you have all kinds of Federal employees located in various agencies — where are they going to get any benefit out of this?

Dr. Cronin. In time it will be worked out for them to get it.

Mr. Keefe. In time this will grow to a point where you will have a diagnostic center everywhere to which Federal employees can be referred. That is what I am afraid of.

.....

²⁶ Report on Federal-State Relations, *op. cit.*, p. 7.

²⁷ *Hearings on Labor-Security Appropriation Bill 1950*, p. 325.

Mr. McGrath. . . isn't it equally true to say that in time the employees would be treated at this center?

.....

Mr. Keefe. So it is limited at the time, but I am thinking once you get your foot in the door, where this will lead to.

The point for concern was even more strongly stated in the Hearings on the 1949 appropriations, when Mr. Anderson said "I wonder if this is not approaching socialized medicine."²⁸ Although so far no large amounts of money have been spent on this program (expenditures were \$97,000 in 1949), nevertheless, we concur with the House Committee on Appropriations in "the hope that this survey activity will be brought to conclusion at the earliest possible date."²⁹

The assumptions made in formulating the recommended level of future expenditure by the Public Health Service are: 1) all grants to the states will be discontinued; 2) an end will have been reached for the construction program. As the record in Table XXXVI shows, the expenditures for constructing both hospitals and research facilities have risen rapidly since 1948. At the rates authorized for 1950, there should be a sufficiency of equipment provided for both of these purposes within a reasonable period. Certainly there is no case now apparent for accepting a high level of expenditures for these purposes over an indefinite period. Essentially, therefore, the reductions from the appropriation level of 1950 involve grants and construction. There is left unimpaired the provision for research, overall counsel and stimulus, and the operation of demonstration clinics in various fields. Again, these are the areas within which scientific activities at the federal level should be conducted.

Office of Education.

The United States Office of Education came into being in 1867 in a bill which was passed by a narrow majority after much Congressional debate on the issue of centralizing educational authority. It was the intent of Congress that education remain a basic responsibility of the states, and the functions of the new organization were limited. The Office remained in the Department of Interior until it was transferred to the Federal Security Agency

²⁸ P. 385.

²⁹ *Report No. 228*, 81st Congress, 1st Session, p. 18.

in 1939. Its traditional, and present, role is to collect statistics, to disseminate information regarding the school systems in the country, and to promote the general cause of education. The Hoover Commission task force on welfare says,³⁰

This subordinate position of the Office of Education is not a matter of mere chance. It is a reflection through Congress of the concern of the States and of the people that the control and administration of education not be nationalized. It has been assumed that control follows money and that status precedes centralization.

The strength and validity of concern on this point has, to date, defeated all efforts to establish a program of federal grants to the states for general school purposes. There are, however, specific grant programs which this office has administered. First are the grants-in-aid established by the Morrill Act of 1862 to land-grant colleges and universities. Second, there are grants under the Smith-Hughes Act of 1917, to states for vocational education. This latter program has since been expanded, notably by the George-Barden Act of 1946. Expenditures, appropriations, and recommendations for the Office of Education are given in Table XXXVII:

TABLE XXXVII
OFFICE OF EDUCATION
(Thousands)

Grants :	Actual Expenditures 1948	1949	Appropriations 1950	Proposed 195X
Vocational education	\$26,538	\$26,122	\$19,978 ^a	—
Colleges of agriculture, etc.	5,030	5,030	2,480 ^b	—
Salaries and expenses	1,492	1,949	1,976	\$1,500 ^c
All other	580	365	—	—
Total	\$33,640	\$33,466	\$24,433	\$1,500

a. Excludes a \$7,150,123 permanent indefinite appropriation authorized by the Act of 1917.

b. Excludes a \$2,550,000 permanent specific appropriation.

c. Three major administrative functions have been transferred recently from this office to the central offices of the Federal Security Agency; also \$522,300 of the 1950 appropriation was specified for administration of vocational education grants.

The grants to colleges of agriculture and mechanic arts, the so-called "land-grant colleges," were instituted in the 1862 Merrill Act, and furthered by the Hatch Act of 1887 and the Smith-Lewis Act of 1914. The aim was to make some agricultural education

³⁰ *Op. cit.*, p. 280.

available to the growing farm population. It was in effect a protest against the type of higher education then available — formal, limited, and classical. These grants were the necessary final steps in the federal stimulation of practical, and vocational, rather than exclusively cultural, education in the nation. The continuance of such grants, however, cannot be justified on the same basis, their original necessity and significance having long since passed, and the amounts in relation to country-wide expenditures for vocational education now being negligible.

The grants to states for vocational education are for specified purposes: agriculture, trades and industry, home economics, teacher training, and distributive occupations. Various formulas apply to the state by state allocation of federal funds. In general, the grants are fixed sums, plus increments allocated on a specific population ratio, on a 50-50 matching basis. State and local support of vocational education has far exceeded this ratio, being about 75 percent of total program costs. The distribution of expenditures by levels of government is indicated below.³¹

	(Thousands)	
	1947	1948
Federal	\$ 21,087	\$ 26,193
State	22,180	25,840
Local	39,985	51,702
Total	\$103,252	\$103,735

Here is a situation quite the reverse of the result of federal aid to welfare programs. This is somewhat spectacular evidence that, once given slight impetus by federal grants, the states and localities can and will support a constructive and preventive program. It also indicates that, with the "prime moving" over, and with tax resources available as recommended in this study, the states and localities can be left alone to maintain and enhance their own programs of vocational education.

The position taken here is that all grants, either to land-grant colleges or to the states, which are now administered by the Office of Education, be discontinued and that the Office confine its activities to the collection and distribution of information

³¹ *Hearings on Labor-Federal Security Appropriation Bill for 1950*, p. 99.

which will facilitate the promotion of the educational programs of the respective states. It is felt that \$1.5 million is a reasonable sum for this purpose.

Office of Vocational Rehabilitation.

The federal government was a late-comer to the field of vocational rehabilitation. As early as 1918 Massachusetts enacted a law providing for the rehabilitation of disabled citizens at public expense. By 1920, twelve states had similar laws. Such programs were a natural sequence to the workmen's compensation programs, which by that time were well established in most industrial states. World War I gave additional impetus to the general movement. In 1920, Congress passed the Vocational Rehabilitation Act, extending grants to states for the development of such programs. The financing of this law required periodic Congressional action, but in 1935 the Social Security Act established permanent authorization for such appropriations, and all states then set up programs approved for the receipt of federal funds. However, it was not until the Barden-La Follette Act of 1943, which liberalized the 1920 Act, that the Office of Vocational Rehabilitation became a constituent unit of the Federal Security Agency.

The functions of this office are to administer the grants-in-aid, establish standards of service, give technical and advisory assistance to the states, keep a general eye on state conformity to federal requirements, and to make cooperative agreements with voluntary and official agencies rendering service in this field.³² The states administer their programs through vocational rehabilitation divisions set up under state boards of vocational education. An individual is eligible for rehabilitation under these programs if he has a mental or physical disability seriously interfering with his capacity to secure or maintain a job. The service and benefits provided by the program include medical examination; medical, surgical or psychiatric treatment, hospitalization up to a period of ninety days for any one disability; prosthetic devices; vocational training and concurrent expenses of maintenance, transportation and study; job counseling and job placement.

³² There are about 25 such agreements. Voluntary agencies generally operate in specific fields, such as cancer, tuberculosis, etc.; there are probably close to 10,000 such agencies in total.

The federal government pays the full cost of such services for war-disabled civilians and for civil federal employees. The cost for other handicapped persons is shared by federal and state government on a 50-50 basis. The federal government also assumes necessary state administrative costs, and the cost of vocational counseling and placement. The proportion of federal funds spent for medical services is increasing; it was not quite 5 percent of appropriations for state grants in 1944, the first year of the liberalized program, and in 1948, it was over 12 percent. Indicative figures follow:³³

(Thousands)

	Appropriations for Grants	Federal Share of Services Purchased for Clients	Federal Share of Expenditures for Medical Services
1944	\$ 6,730	\$1,700	\$ 335
1945	8,000	2,674	598
1946	11,705	3,750	895
1947	12,360	5,131	1,429
1948	18,000	6,876	2,171

With the 1950 appropriations, federal responsibility will have tripled since 1944. The current fiscal picture of this federal office, with recommendations for future expenditures, are given below:

(Thousands)

	Actual Expenditures 1948	Actual Expenditures 1949	Appropriations 1950	Proposed 195X
Grants	\$21,842	\$14,822	\$20,500	—
Salaries and Expenses	616	675	685	\$500
Total	\$22,458	\$15,497	\$21,185	\$500

Any field into which the federal government enters so directly to extend medical services and treatment to civilians is a dangerous area for federal activity. Veterans' care is one thing; but this is quite another. The provision of care and treatment for the needy, disabled, unemployed is by tradition and logic the jurisdiction of states and localities. The states were on their way to establishing rehabilitation services, even as they had workmen's compensation systems, without federal funds or facilitation. It is a field which

³³ Hoover Commission Task Force Report on *Public Welfare*, p. 222.

should be left to independent state functioning. It is a valid, practical program where results can be counted in dollars, jobs and production. States will undoubtedly continue such activity without federal grants. With the allocation of tax sources herein proposed for the states, there will be ample capacity for them to carry and extend these programs, free of federal stipulations and restrictions. In this field, unlike federal-state public health relations, but like public assistance program relations, the state agencies "have experienced considerable difficulty in determining their exact areas of authority and responsibility vis-a-vis the national agency."⁸⁴

There is every reason why programs of this nature should be immediately freed of federal control, and no sustaining reason for the continuance of federal activity. The position taken here is that federal grants for these purposes be eliminated, and the Office of Vocational Rehabilitation confine itself to general promotion, advice, perhaps research similar to studies conducted by the Public Health Service but strictly related to matters of disability and rehabilitation, and to cooperative arrangements between public and private rehabilitation agencies. With the costs of administering grants eliminated, it is felt that \$500,000 annually would permit adequate activities of this kind.

School Lunch Program.

The federal government, through the Department of Agriculture, first participated in the provision of school lunches during the depression of the 1930's as a means for using surplus agricultural commodities and to furnish work to the unemployed. Thereafter, it was carried ostensibly as an agricultural function, and was associated with the farm price support program; but in 1946 it was given somewhat independent status, at least as far as purpose was concerned, by the National School Lunch Act. This Act declared it to be the policy of Congress

to safeguard the health and well-being of the nation's children and to encourage the domestic consumption of agricultural commodities and other food, by assisting the states, through grants-in-aid and other means, in providing . . . school lunch programs.

⁸⁴ Hoover Commission, Task Force on *Federal-State Relations*, Mimeo Appendix, p. 29.

The requirements imposed on the states for receipt of federal funds clearly indicate the change in the nature of the program from one for the use of surplus agricultural commodities to one of health and welfare: certain nutrition standards must be met; it must be a non-profit program; meals must be served free or at reduced cost to those unable to pay full cost. It is in fact no longer even required that surplus foods be used. When surplus foods were so used, it was certainly a worthier means of their disposal than direct destruction. But currently there is no relevant tie-in with farm price support activities. Emphasis is wholly on the dietary needs of children, and the fiscal need of the states; in fact it has even been suggested that school authorities be required to certify their need of federal funds before becoming eligible.³⁵ For these reasons, there is hardly any case for classifying the program as "educational," which was done by the Hoover Commission Task Force on Welfare. That report says "no good can come from an extended and academic discussion of this question."³⁶ But only by a proper identification of the purpose and function of the program can it be dealt with properly.

The present link between this program and the Department of Agriculture is not one of purpose or function but rather one of financing. The program is supported out of earmarked Section 32 funds (30% of custom receipts of the previous calendar year) which compose permanent appropriations for exportation and domestic consumption of agricultural commodities. Transfers from that appropriation provide the funds for the school lunch program, which now amount to more than \$75 million a year.

The state by state distribution of grants for 1948 is shown in Table XXXVIII. Public, nonprofit private, and parochial schools are eligible for funds. It is estimated that only about a fourth of all eligible schools throughout the nation are now in the program, and that full extension to all schools would require an annual federal expenditure of \$600 million.³⁷

The position taken here is that the provision of school lunches is distinctly a feature of public health and welfare services, and as

³⁵ *House Committee Report, No. 450, 80th Congress, 1st Session, on Agricultural Appropriation Bill of 1948*, p. 27.

³⁶ *Op. cit.*, p. 288.

³⁷ *Op. cit.*, p. 28.

such is not a proper sphere for federal activity. It should be left exclusively to the states and localities. On this point, the House Committee on Appropriations made pertinent comment two years ago:³⁸

There is a considerable body of opinion to the effect that the Federal Government should step out of the school-lunch program entirely on the ground that this is essentially and primarily a State function and that the States can well afford to carry on this program from their own resources. It is all important that the responsibility for the financing of this program should be shifted back to the States as rapidly as possible, else many of the measures now being undertaken to bring the Federal Government more firmly within the realm of solvency will be aborted. It should be borne in mind that the cost of feeding destitute children in foreign countries falls very largely upon the United States, an obligation which rests 100 percent upon the Federal Treasury. It does not seem too much to suggest that the cost of school lunches for the children of America, most of whom are able to pay for them, might well be borne by the States.

Bureau of Community Facilities.

This bureau was a war-child, created by order of the administrator of the Federal Works Agency in 1944, to carry out public works construction connected with national defense which had been authorized by the Lanham Act of 1940. Among other things this act provided for grants-in-aid for recreational facilities in communities affected by the defense and war program.

The purposes for which the Bureau was established ceased to exist with the end of the war. Prompt liquidation should have followed. Instead, the Bureau was retained for various miscellaneous, temporary activities, a delaying action which served in this instance, as similar tactics have elsewhere, to carry the agency on the books until some new program could be found. In the present case, a division of the newly-created General Services Administration — "Community Facilities-Federal Aid," reveals how hardy is the genus "Federal Public Agency." The budget estimate for 1951 anticipated an expenditure under this new division of \$2,-826,000. The inherent tendency of an unmanageable organization toward duplication is shown by the inclusion, in this new agency, of an item for water pollution control, a matter also under the Public Health Service; and also of items for public works in

³⁸ *Ibid.* p. 27.

Alaska and the Virgin Islands, both of which are under the jurisdiction of the Department of the Interior ; and finally, a small item for veterans' educational facilities, a matter which is covered in various other places.

There is no sound reason for continuance of a separate agency for these operations. It should be discontinued before it can grow to larger proportions.

Housing and Home Finance Agency.

This agency is engaged in a variety of operations of a character that warrant its inclusion in the general category of activities dealt with in this chapter. The expenditures shown for it in Table XXX include administrative costs. An examination of the description of the scope of the Housing and Home Finance Agency in the 1951 Budget³⁹ will reveal that here is an excellent example of the mushroom type of agency expansion.

On the other hand, the methods by which the Agency carries out the purposes for which it was established are such, in the main, as would justify treatment of it in Chapter 11. That is, The Housing and Home Finance Agency is engaged principally in lending, insuring, and guaranteeing, and the comments made in Chapter 11 on these aspects of governmental intervention in the economy apply, with equal propriety, to this Agency as to all other federal agencies similarly engaged.

* * * *

Conclusions:

1. The original need for and purpose of federal participation in the provision of welfare services and assistance no longer exist. The states are administratively able, and with the tax allocation proposed by this study, will be financially able, to assume these functions.
2. The federal government has encroached unnecessarily on

³⁹ Pp. 309-376.

the traditional jurisdiction of the states; the proper and limited sphere of federal activity is the promotion, not the provision, of economic and welfare measures.

3. Grants-in-aid involve unnecessary and expensive federal administration, force the states into unwarranted dependency on the Federal Treasury, and mislead the people into assuming that big government means big benefits at little local cost.
4. Under the proposals of this program federal expenditures for the promotion of economic and social welfare may be reduced from the 1949 level of \$2,339 million to \$446 million for 1954.

Recommendations:

In accordance with the plan of reallocation of functions to the states:

1. All grants to the states for social welfare purposes should be discontinued: public assistance, maternal and child health and welfare, public health, vocational rehabilitation and education, school lunches, and employment security.
2. The following federal organizations should be abolished: Bureau of Employment Security, Bureau of Federal Credit Unions, Bureau of Public Assistance, Children's Bureau, Division of Federal Employee Health, Division of Hospital Facilities (regarding the Hospital Construction Act), and the Division of Community Facilities-Federal Aid in the General Services Administration.
3. Such federal activity and responsibility as remain should be limited to the promotion of economic and social welfare through research, stimulus to state and local agencies, and overall leadership.
4. Complete responsibility for the unemployment compensation systems, including the management of all current tax receipts, should be released to the states.

TABLE XXXVIII

SUMMARY OF GRANTS-IN-AID FOR ECONOMIC AND SOCIAL WELFARE, 1949

(Thousands)

	1 Public Assistance	2 Maternal and Child Welfare	3 Public Health	4 Vocational Purposes	5 School Lunch	6 Employment Security	7 Total
Alabama	\$ 17,334	\$ 894	\$ 1,776	\$ 1,067	\$ 2,901	\$ 2,391	\$ 26,363
Arizona	5,234	235	246	411	415	1,000	7,537
Arkansas	13,004	551	808	604	2,012	1,261	18,240
California	83,554	737	1,706	2,530	3,025	16,640	108,192
Colorado	17,738	245	276	340	549	1,033	20,181
Connecticut	6,113	282	364	609	600	2,404	10,372
Delaware	652	117	110	295	86	325	1,585
District of Columbia	1,567	258	296	87	133	1,002	3,343
Florida	26,596	381	1,883	919	1,377	2,100	33,256
Georgia	20,197	864	1,977	1,658	3,043	2,013	29,752
Idaho	4,057	173	212	206	304	719	5,671
Illinois	49,046	689	2,870	2,425	2,674	6,762	64,466
Indiana	16,870	351	805	1,015	1,651	2,748	23,440
Iowa	17,176	365	456	772	1,233	1,200	21,202
Kansas	13,170	283	573	576	902	1,187	16,691
Kentucky	14,875	732	1,313	880	2,550	1,371	21,721
Louisiana	44,875	599	1,504	920	2,214	1,854	51,966
Maine	5,073	223	345	266	327	823	7,057
Maryland	5,818	467	589	584	795	2,481	10,734

TABLE XXXVIII (Cont'd)

Massachusetts	37,185	491	1,046	755	1,509	5,572	46,558
Michigan	37,214	602	1,233	1,960	2,513	7,416	50,938
Minnesota	19,866	494	589	808	1,473	2,382	25,612
Mississippi	10,790	690	1,522	983	2,271	1,483	17,739
Missouri	45,403	434	696	1,179	1,740	2,129	51,581
Montana	4,549	191	221	299	246	651	6,157
Nebraska	8,690	231	317	476	436	748	10,898
Nevada	818	103	72	93	52	461	1,599
New Hampshire	2,555	141	120	181	218	706	3,921
New Jersey	9,437	369	1,383	930	1,320	5,766	19,205
New Mexico	4,344	249	356	247	390	665	6,251
New York	57,901	770	2,078	3,068	4,181	18,625	86,623
North Carolina	13,513	850	1,952	1,604	3,368	2,639	23,926
North Dakota	3,478	184	240	252	277	441	4,872
Ohio	44,362	644	1,532	1,675	2,787	6,484	57,484
Oklahoma	44,682	431	1,084	989	1,890	1,581	50,657
Oregon	8,620	221	535	423	657	1,915	12,371
Pennsylvania	42,910	941	1,707	2,886	2,730	10,669	61,843
Rhode Island	4,012	149	155	211	216	1,130	5,873
South Carolina	9,300	673	1,145	924	2,042	1,502	15,586
South Dakota	4,061	182	199	218	30	354	5,044
Tennessee	19,352	673	1,262	1,240	2,479	2,432	27,438
Texas	62,936	1,037	2,827	2,207	4,471	4,645	78,123
Utah	4,691	220	236	288	475	808	6,718

TABLE XXXVIII (Concl)

SUMMARY OF GRANTS-IN-AID FOR ECONOMIC AND SOCIAL WELFARE, 1949
THOUSANDS

	1 Public Assistance	2 Maternal and Child Welfare	3 Public Health	4 Vocational Purposes	5 School Lunch	6 Employment Security	7 Total
Vermont	2,070	141	166	234	183	475	3,269
Virginia	5,700	717	864	1,017	1,838	1,572	11,708
Washington	26,725	374	423	684	984	3,188	32,378
West Virginia	9,014	455	619	815	1,386	1,198	13,487
Wisconsin	17,108	473	652	1,061	1,442	2,111	22,847
Wyoming	1,619	89	99	216	157	376	2,556
Alaska	570	225	356	—	11	378	1,540
Hawaii	1,476	306	194	264	231	339	2,810
TOTALS	\$927,897	\$22,195	\$43,985	\$44,341	\$70,795	\$140,155	\$1,249,368

Source: *Annual Report of the Secretary of the Treasury, 1949, Table 98, Part A.*

Notes for columns as indicated:

1. Includes Old Age Assistance, Aid to Dependent Children, and Aid to the Blind. The distribution of the national total is as follows: OAA, \$718.0 million; ADC, \$189.4 million; AB, \$20.5 million.
2. The national distribution of the programs involved is as follows: Maternal and Child Health, \$10.7 million; Services for Crippled Children, \$7.9 million; and Child Welfare Services, \$3.6 million.
3. Includes five programs with national totals as follows: Venereal Disease, \$12.8 million; Tuberculosis, \$6.6 million; General Health Assistance, \$11.0 million; Mental Health Activities, \$2.9 million; and Hospital Survey and Planning, \$10.8 million.
4. Includes Cooperative Vocational Education, and Office of Vocational Rehabilitation, for which the respective national expenditures were \$25.8 million and \$18.6 million.

CHAPTER 10

WAR-CONNECTED COSTS

In this chapter there is presented a review of war-connected costs, and recommendations with respect to future programs of this character. Preceding chapters have dealt with the broad categories of nonwar cost.

A summary of the war-connected costs is presented in Table XXXIX.

TABLE XXXIX

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDATIONS FOR WAR-CONNECTED COSTS

(Thousands)

Agency	Actual Expenditures 1948	1949	Appropriation 1950	Proposed, 195X
Costs from past wars :				
Interest on war debt	\$ 4,534,000	\$ 4,611,000	\$ 4,894,000 ^b	\$ 5,000,000
Veterans' care & benefits	6,597,735 ^a	6,595,053 ^a	5,614,559	3,387,015
Sub-total	<u>\$11,131,735</u>	<u>\$11,206,053</u>	<u>\$10,508,559</u>	<u>\$ 8,387,015</u>
National security :				
Defense establishment :				
Army	5,420,290 ^c	5,329,781 ^c	4,481,835	3,836,000
Navy	4,272,401	4,425,696	4,375,327	3,826,000
Secretary of Defense	342	6,727	191,450 ^d	200,000
National Security Council	52	113	200	200
National Security Resources Board	553	2,476	3,500	4,000
Atomic Energy Commission	465,587	620,938	703,229	500,000
Stock piling				
Selective Service System (including records office)	7,641	17,476	8,500	—
Sub-total	<u>\$11,389,525</u>	<u>\$12,502,079</u>	<u>\$14,379,772</u>	<u>\$12,379,000</u>

Agency	Actual Expenditures		Appropriation	Proposed,
	1948	1949	1950	195X
Foreign aid	\$3,625,682	\$5,037,719	\$4,240,521	—
Occupation costs	956,096	1,349,275	912,500	—
Arms aid	—	—	814,000 ^a	—
Sub-total	4,590,778	6,386,994	5,567,021	—
Grand total	\$27,112,038	\$30,222,646	\$30,855,352	\$20,766,215

a. Includes expenditures for construction by Corps of Engineers.

b. An apportionment, not an exact appropriation. See below.

c. Part of the expenditure for the Air Force was included in the Army budget in 1948 and 1949.

d. The appropriation act for 1950 brought together in one account, in the Secretary's Office, the various appropriations for retired pay.

e. In addition, 500 million in contract authorization.

In the tables and discussion that follow, the several items in the above overall table are dealt with in order.

Interest on War Debt.

It was explained in Chapter 1 that an apportionment of the total federal debt between war and nonwar purposes was made, in order to complete the record of total war-connected costs. On the basis of this apportionment, it was found that 87 percent of the total debt outstanding at the end of February, 1946, had been issued for war costs in the past, through and including the financing of the Second World War. The total amount budgeted as interest on debt has been distributed by application of this percentage. The remainder of the total interest charge is carried as a nonwar cost, and is shown in Chapter 6. The estimate of interest for 1950 is used for the future apportionment shown in Table XXXIX.

Veterans' Care and Benefits.

The record of expenditures and appropriations, together with the recommended future expenditure for veterans' care and benefits, is given in Table XL.

TABLE XL

EXPENDITURES, APPROPRIATIONS AND RECOMMENDATIONS FOR VETERANS' CARE AND BENEFITS
(Thousands)

Service	Actual Expenditures		Appropriation	Proposed,
	1948	1949	1950	195X
Administrative, medical, hospital and domiciliary services	\$ 893,364	\$ 929,859	\$ 855,000	\$ 800,000
Printing and binding	4,674	^a	^a	—
Tort Claims	9	19	15	15
Pensions	2,080,130	2,153,828	1,998,801	2,300,000
Readjustment benefits	3,237,896	3,247,406	2,197,503	50,000
Military & naval insurance	8,371	7,381	3,735	4,000
Hospital & domiciliary facil.	52,970 ^b	141,515 ^b	^c	100,000
National service life insurance	142,265	87,656	467,450 ^d	50,000
Veterans' miscellaneous benefits	79,735	86,335	75,330	75,000
Cemeterial Expense	86,713	57,195	4,500	5,000
U. S. Soldiers Home	677	889	2,428	2,500
Naval Home	348	381	397	500
All other	10,583	10,109	9,400	—
Totals	\$6,597,735	\$6,722,573	\$5,614,559	\$3,387,015

a. Consolidated with preceding item in 1950 appropriation bill.

b. Includes construction by Corps of Engineers; 1948, \$35,894,000; 1949, \$107,520,000.

c. Appropriation bill for 1950 extended contract authorizations to June 30, 1951. The Budget had recommended rescission of \$237 million of such authorizations.

d. Includes anticipated supplemental appropriation of \$412,590,000 for 1949.

The following comments on the principal items of expenditure for veterans' care and benefits are based chiefly on the testimony taken in connection with the 1950 appropriation bill and the reports of the Hoover Commission.

Administrative, Medical and Other Services.

The House subcommittee in charge of this bill stated that the reductions in administrative and other expenses in this category resulted principally from reduced needs in all programs other than medical and hospital care. The total cost of the medical program, which is included in the total for this item, is allowed at \$566,666,400 for 1950. Among the instances of bad organization and direction cited by the subcommittee were cases of doctors and dentists performing administrative work; excessive costs in the District of Columbia; excessive expenses in connection with supply and real

estate operations; and for the operations, and the supervision of work done by, the Corps of Engineers; and excessive costs in the handling of veterans' insurance.

The Hoover Commission commented briefly on the internal organizational defects of the Veterans' Administration, and recommended a reorganization of the Washington office in accordance with the general principles suggested in another report. The Commission indicated that savings would result from such a reorganization but offered no concrete estimate. It is suggested here that the total cost of administrative, medical, hospital and domiciliary services, under proper coordination and management, should not be more than \$800 million.

Pensions.

The House subcommittee stated, in its report on the 1950 bill, that consideration had been given to the fact that the funds required for pensions are the result of a mathematical calculation. The Veterans' Administration presented data to show that the number of beneficiaries and the cost of benefits arising from service in all wars prior to World War II were declining, while the case load and cost of pensions based on World War II service were rising. The Hoover Commission stated that a projection by its task force indicated that total pension payments would rise to \$2.7 billion in ten years. This projection does not take into account, obviously, any of the schemes for broad increases in pensions that have recently been put forward. For lack of a more definite approximation, the Hoover Commission figure is here used to indicate the probable level of pension costs, with the realization that it is a projection that is not intended to apply until a decade has elapsed.

Readjustment Benefits.

The House subcommittee gave the following explanation of its reductions for this item:¹

The principal reduction in the requirements for 1950 as compared with the 1949 fiscal year arises from the reduced number of veterans availing themselves of education and training privileges as well as reduced payments under the readjustment allowance program resulting from expiration of

¹ Report from the Committee on Appropriations, House of Representatives, to accompany H.R. 4177, *Independent Offices Appropriation Bill, 1950*, p. 36.

eligibility for these benefits on July 25, 1949, for all veterans discharged or released from the service prior to July 25, 1947, the official end of the war.

Veterans' Administration representatives testified that there would be an average of 1,575,000 veterans in training in 1950, as against 2,000,000 in 1949. Statutory limitations will hasten this decline, for present law requires that a veteran initiate his course of training before July 25, 1951, and complete it by July 25, 1956. The Administrator, General Gray, stated that a considerable number of veterans who had not entered training courses, although eligible to do so, had been influenced by the current employment opportunities. He suggested that an adverse turn in the employment situation would cause a substantial rise of enrollment. This could happen, of course, but any subsequent reversal in the direction of enlarged employment opportunities again would no doubt lead to a very rapid decline among those who were simply using the training opportunity as a stopgap.

The record of recent budget forecasts regarding the number of veterans to draw readjustment benefits, and the cost, has been quite irregular. In the budget for 1951 the estimates are up again, in contrast with the decided decline that was projected a year earlier. But in the 1951 Budget Message the suspicious circumstances which require thorough investigation were stated as follows:²

The continued expansion of enrollment in schools below college level, more than 4 years after most veterans have been returned to civilian life, raises the question whether this program still conforms to the original sound objectives of the Servicemen's Readjustment Act — to enable veterans to resume education or training interrupted by the war or to restore skills lost during military service. There is some question whether large numbers of veterans enrolled in these schools are in fact being trained for occupations for which they are suited and in which they will be able to find jobs when they finish their training.

It is apparent that the whole readjustment program, with the possible exception of the loan guaranty, will eventually be closed out. The estimated outgo in 1950 for interest, guaranteed losses, and property acquisition was \$47,871,000. By far the largest part of the contingent liability assumed under the loan and guaranty provisions has been for the acquisition of homes by veterans. The

² *The Budget for the Fiscal Year 1951*, p. M38.

Hoover Commission made the point that this program involved the Veterans' Administration in complicated matters of lending and real estate management, and recommended that the veterans' housing loan guaranty program be transferred to the Housing and Home Finance Agency, except for the certification of eligibility of veterans to these guaranties.

Veterans' Life Insurance.

There are two systems of veterans' life insurance in operation, and it will be convenient to deal with them together. The two systems are:

1. United States Government Life Insurance, which was the system inaugurated after the first World War in substitution for the original war risk insurance;
2. National Life Insurance, which was introduced in 1940 as the successor to the earlier system.

With respect to certain financial features, the two systems have the following provisions in common:

1. The insured persons are to pay premiums determined by reference to the American Mortality Table, and the payments are to accumulate at 3 percent interest;
2. The government is to pay the costs of administration, and all costs incurred in meeting policy obligations that are attributable to the extra hazard of military service;
3. The government payments are also to include waivers of premium on account of total disability;
4. All policies in force contain provisions which entitle the insured to participation in any dividend distributions that are made.

Under each system, the policies were originally issued as yearly renewable term insurance, with the privilege of conversion into any standard form of insurance. The time limit for conversion was originally five years, but it has been extended by various amendments which make possible, in certain cases, a maximum of 13 years of term insurance.³

Military and Naval Insurance.

This item in Table XL refers to the appropriation for payments into the United States Government Life Insurance fund. The

³ Administrator of Veterans' Affairs, *Annual Report, 1948*, p. 65.

theory of such payments, which are considered as reimbursements to the fund, is that the government shall cover the cost in cases of policy obligations traceable to the extra hazards of military and naval service.⁴ Through the calendar year 1948, the total amount received from the government on account of this extra hazard was \$138,008,000, which is to be compared with total premium receipts of \$1,546,304,000 for the same period.⁵ In other words, the burden on the taxpayers, on account of the military hazard involved in the first World War insurance, has not been more than some 9 percent of the total premium payments by the policy holders. During the same period, that is, through December 31, 1948, dividends paid to policy holders totalled \$174,305,000, or about 11 percent of total premium receipts.

As of June 30, 1949, there were 507,449 government life insurance policies in force, with a total value of \$2,210 million. The financial statement of the fund showed, as of December 31, 1948, a reserve of \$1,190 million. In view of the plans now going forward with respect to the national life insurance fund, it is significant that the government life insurance fund reserve is now about one-half of the face amount of the policy liabilities, and that this fund, except for the \$138,008,000 contributed by the government, has been built up by the insured veterans whose premium payments have been augmented by the interest accumulation, deposits of dividends, and other minor items. Meantime, the dividend distributions have been moderate in relation to the payments.

The situation with respect to the national life insurance fund, reserves, and other matters is not too clear, for the Veterans' Administration publishes only the most scanty statistical information on these matters in the annual reports. As of June 30, 1949, there were 7,258,000 national service life insurance policies in force, with a total face value of \$41,743 million. It should be noted that 5,585,360 of these policies, with a face value of \$34,385 million, were still in the form of 5-year level premium term insurance. In the hearings before the House subcommittee on the 1950 appropriation bill, it was testified that the government had contributed some

⁴ *Report of the House Appropriations Committee on Independent Offices Appropriation Bill, 1950*, p. 231.

⁵ Administrator of Veterans' Affairs, *Annual Report, 1949*, p. 205.

⁶ *Annual Report of the Administrator of Veterans Affairs, 1949*, p. 74.

\$4 billion to the national life insurance trust fund, including a supplemental budget request for \$413 million which was said to be absolutely necessary, and that the insured veterans had paid, in premiums, another \$4 billion. In addition, the government had paid all administrative expense.⁷

The cumulative record of receipts and expenditures of the National Service Life Insurance Fund through June 30, 1949 is as follows:⁸

Receipts:

Premiums and other receipts	\$4,205,970,688
Interest and profits on investments	789,584,727
Transfers from general fund	3,687,278,053 ^a

Total receipts	\$8,682,833,468
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Expenditures:

Benefit payments and refunds	1,375,525,414
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Items in transit	+ 619,140
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Total	1,376,144,554
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Balance	\$7,306,688,914
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- a. The above total of transfers from the general fund does not include the requested supplemental appropriation of \$412,590,000 in 1949, which, if approved, would bring the government's total contribution to more than \$4 billion.

The amount which the government has paid into the national life insurance trust fund is not explicable by reference to the terms of the law. The legal provision in this subject is as follows:⁹

Whenever benefits under such insurance become payable because of the death of the insured as the result of disease or injury traceable to the extra hazard of military or naval service, as such hazard may be determined by the Administrator, the liability for payment of such benefits shall be borne by the United States in an amount which, when added to the reserve of the policy at the time of the death of the insured, will equal the then value of such benefits under such policy.

This passage appears to define rather explicitly the responsibility of the government as being the obligation to make up any difference between the amount paid by any policyholder in premiums plus the interest accrual on those payments, and the total payable under the policy. This obligation exists only in the cases in which death is found to be the result of disease or injury traceable to the extra military hazard. There is a rather wide loophole in the authorization

⁷ *Hearings on Independent Offices Appropriation Bill, 1950*, p. 305.

⁸ *Annual Report of the Secretary of the Treasury, 1949*, p. 514.

⁹ *U. S. Code, Title 38, Section 807 (b)*.

to the Administrator to determine the contribution of the extra hazard to the death. Under the terms for payment of policies, it is possible that more than the face amount must eventually be paid out. The law provides that if a beneficiary is thirty or more years of age at the time of maturity of the policy, the insurance shall be payable in 120 equal monthly installments certain, with such payments continuing during the remaining lifetime of such beneficiary.

These circumstances indicate a contingent liability of the government which, though indefinite, is capable of reasonably close approximation. The VA insurance expert who testified in the 1949 hearings said, with reference to the losses chargeable to the government:¹⁰ "Of course, the curve will go down very sharply as time goes on, so from now on the losses charged to the government should be comparatively small."

Until there is more light on the subject, it is assumed here that the amount allowed by the House Bill for 1950, say \$50 million in round figures, will be sufficient to cover the government's contingent liability for the extra military hazard, particularly in view of the forecast in 1949 that the curve of losses chargeable to the government should decline sharply in future.

The Hoover Commission recommended that the insurance operations of the Veterans' Administration, including the processing of death claims, be separated from all other programs and be organized as a government corporation. It is generally recognized that the veterans' insurance system is in a chaotic condition, notwithstanding that some improvement appears to have been accomplished under the present administrator. The Hoover Commission concludes its argument for transfer to a separate unit as follows:¹¹

The corporate form of management for insurance activities could accomplish no miracles overnight in improving the operation of insurance programs. It would provide an opportunity for a fresh start. It would make possible a whole new emphasis upon the economical and efficient performance of the insurance program.

Veterans' Hospitals. One of the conspicuous cases of expenditure reduction in the President's budget for 1950 was the proposed rescission of \$237 million in the contract authorizations for vet-

¹⁰ *Ibid.*, 1949, p. 438.

¹¹ Hoover Commission, report on *Veterans' Affairs*, p. 16.

erans' hospital construction. This action was explained as follows in the justifications submitted to the House Appropriations Committee:¹²

This reduction is recommended after a restudy of the VA hospital construction programs which were planned and authorized during and shortly after World War II. In the light of our postwar experience, and in relation to foreseeable total needs and the needs in geographic areas it has been concluded that 23 proposed hospitals and the proposed addition to one existing hospital can be eliminated, another 14 reduced in size, and one proposed hospital should be increased in size to partially offset an elimination. These eliminations and changes in size of proposed hospitals will result in a net reduction of about 16,000 authorized beds and still provide for all service-connected patients as well as provide for an even more liberal allowance for non-service-connected patients than at present.

The Administrator, General Gray, stated that this cutback in hospital construction was not initiated by the Veterans' Administration. But his chief medical director testified that it was not possible to staff and service more than 120,000 hospital beds, and the cutback would leave the ultimate equipment at about that figure.

The House subcommittee on appropriations did not accept the rescission. Its explanation was as follows:¹³

The committee is of the opinion that this reduction of program originated in the Bureau of the Budget and, perhaps, was not thoroughly considered. Therefore, it has eliminated the proposed rescission of \$237,000,000 of contract authorization from the bill, so that should the President decide that all or any part of the proposed hospital program which the Budget had eliminated is necessary, the authorization to proceed with the work will be available.

This is an appropriate place at which to refer to the Hoover Commission's discussion of medical activities generally. An immense and costly program of hospitals for veterans has been authorized by the Congress, the total cost of which would be \$1,177 million. The various branches of the defense services also have large equipment in hospitals and are planning additional construction. The Hoover Commission criticizes the existing situation as follows:¹⁴

The enormous and expanding Federal medical activities are devoid of any central plan. Four large, and many smaller Government agencies,

¹² *Ibid*, 1950, p. 232.

¹³ *Report on Independent Offices Appropriation Bill, 1950*, p. 37.

¹⁴ Hoover Commission report on *Medical Activities*, p. 7.

obtain funds and build hospitals with little knowledge of, and no regard for, the needs of the others. They compete with each other for scarce personnel. No one has responsibility for an overall plan. There is not even a clear definition of the classes of beneficiaries for whom care is to be planned. The Government is moving into uncalculated obligations without an understanding of their ultimate costs, of the lack of professional manpower available to discharge them, or of the adverse effect upon the hospital system of the country.

The irony of this statement is that it is applicable to many other aspects of the federal government than medical programs. Everywhere there is duplication, or multiplication, of agencies engaged in the same or similar activities; everywhere there is competition for personnel, and too frequently, a lack of clear definition of objectives. Nowhere is there any evidence of concern over the mounting obligations and destructive ultimate costs of these ambitious programs, or of their effect upon the national economy. The federal government is everywhere too big, too costly, too cumbersome and inflexible, to be managed efficiently by any group of men. The central purpose of the program of re-allocation being developed here is to reduce its size to manageable proportions and its cost to an endurable level.

Beyond question, in the case of the hospital programs, there is wasteful construction, unnecessary duplication of facilities and a serious dilution of service standards through scattering of the limited supply of competent professional personnel. Some improvement might be secured from the united medical administration which the Hoover Commission recommended. This would not be, however, a sufficient corrective, for such an administration would not necessarily be able to restrict the huge appropriations for more hospitals and other medical care. There must be a changed conception of the place of the federal government, and such a change can come only from renewed emphasis upon the responsibilities of the states, the cities, and private groups in the entire health program. When the states have larger tax resources, and the citizens have more of their own incomes left at their disposal, it will no longer be necessary, or even appear to be necessary, for the Congress to appropriate billions for the wasteful duplication of hospital and other medical facilities.

In view of the critical comments that have come from the Hoover Commission and other sources with respect to the wasteful

and unnecessary scope of the veterans' hospital construction program, it is suggested that a regular annual allowance for this purpose of \$100 million would be ample, even liberal.

National Security. It is appropriate, as an introduction to the data relating to national security, to quote from the report of the House subcommittee on the appropriation bill for the fiscal year 1950:¹⁵

The cost of maintaining the National Military Establishment in a position ready to perform the assigned duties is tremendous. There is no doubt that additional funds could be utilized toward many things that might be desirable but which it is hoped may wisely be laid aside at this time. Those who have prepared and who recommend the national defense budget as well as Members of the Congress must consider national defense in the light of the national economy and take calculated risks weighted with all known factors.

The totals of funds proposed in the House appropriation bill for 1950 may be summarized in Table XLI:

TABLE XLI
SUMMARY OF APPROPRIATIONS AND AUTHORIZATIONS FOR
NATIONAL DEFENSE, 1950

(Millions)				
Purpose	Army	Navy	Air Force	Totals
Cash for new obligation	\$4,262	\$3,584	\$3,348	\$11,194
Cash to liquidate prior contracts	220	791	875	1,886
Subtotal, cash appropriations	4,482	4,375	4,223	13,080
New contract authorizations	—	643	1,993	2,636
Total cash and authorizations	\$4,482	\$5,018	\$6,216	\$15,716

The total personnel to be supported during the fiscal year 1950, military and civilian, is expected to be 2,539,807. The distribution between military and civilian personnel for each of the three services is shown in Table XLII:

TABLE XLII
PERSONNEL STRENGTH, MILITARY ESTABLISHMENT, 1950

	Army		Navy		Air Force	
	Number	%	Number	%	Number	%
Average strength						
Military	677,000	63	527,271	59	412,273	71
Civilian	394,136	37 ^a	359,185	41	169,942	28
Total personnel	1,071,136	100	886,456	100	582,215	100

a. Includes civil functions and foreign aid. Cadets and midshipmen excluded from military personnel.

¹⁵ *Op. cit.*, p. 5.

The House subcommittee in charge of the National Military Establishment bill for 1950 was apparently not greatly disturbed by the program to employ 923,263 civilians in support of, and supplement to, a total military personnel of 1,616,544, which is a ratio of one civilian to somewhat less than two men in uniform (the ratio is 1-1.75). In fact, provision was made for some increase of civilians to be employed by the Air Force, and for some minor reductions of civilian personnel in the other two services.

The record of expenditures and appropriations for Army, Navy, and Air Force, respectively, is given in the tables which follow:

TABLE XLIII

EXPENDITURES, APPROPRIATIONS, AND RECOMMENDED
COST OF THE ARMY

(Thousands)

Unit	Actual Expenditures		Appropriation	Proposed,
	1948	1949	1950	195X
Secretary of the Army	\$ 199,147	\$ 42,174	\$ 44,169	
General staff corps	4,455	6,312	6,895	
Finance department	2,728,642 ^a	2,432,074 ^a	1,556,615	
Quartermaster corps	742,405	923,184	673,600	
Transportation corps	392,252	409,624	340,000	
Signal corps	85,927	113,371	200,000	
Medical department	49,193	72,888	68,031	Not
Engineers corps	608,638	556,265	400,407	dis-
Ordnance department	287,947	326,701	730,000	tributed.
Chemical warfare corps	23,758	24,427	35,000	See
Army field forces	4,118	4,098	4,457	Table
U.S. Military Academy	7,325	7,780	8,524	XLVII.
National guard	123,604	227,461	216,000	
Organized reserves	43,959	88,467	115,000	
R.O.T.C.	16,146	20,785	25,000	
Natl. Bd. for Promotion of Rifle Practice	255	245	273	
Department salaries	18,096	17,049	57,864	
Miscellaneous ^c	84,431	56,876	—	
Totals	\$5,420,290	\$5,329,781 ^b	\$4,481,835	\$3,836,000

a. Air Force figures included, but not given separately, for 1948 and 1949.

b. The totals for 1948 and 1949 exclude foreign aid and relief expenditures charged to the Army as follows: 1948 — \$233,003,000; 1949 — \$285,404,000.

c. Expenditure for the Army of the Philippines.

TABLE XLIV
EXPENDITURES, APPROPRIATIONS, AND RECOMMENDED
COST OF THE NAVY
(Thousands)

Unit	Actual Expenditures 1948	Actual Expenditures 1949	Appropriation 1950	Proposed, 195X
Office of the Secretary :				
Contingencies of the Navy \$	16,915	\$ 11,177	\$ 18,600	
Operation & conservation of naval petroleum re- serves	2,373	4,860	9,500	
Exploration of petroleum reserve No. 4	4,606	7,626	—	
Salaries	4,048	4,236	4,321	
Miscellaneous	27,333	13,419	4,300	Not
Sub-total, Secretary's Office	55,275 ^a	41,318 ^a	36,721	
Bureau of Naval Personnel	149,380	179,528	1,278,366	dis-
Bureau of Ships	336,698	428,380	570,200 ^b	
Bureau of Ordnance	213,302	243,512	359,854 ^c	
Bureau of Supplies and accounts	1,882,361	1,715,963	466,874 ^d	tributed.
Bureau of Medicine and Surgery	30,204	47,021	40,972	See
Bureau of Yards and Docks	270,683	235,031	207,265	
Bureau of Aeronautics	741,239	872,431	1,042,121 ^e	
Marine Corps	271,486	307,964	319,005	Table
Shipbuilding	276,337	296,113	f	
Other Salaries and miscellaneous	7,001	9,132	1,530 ^g	XLVII.
Island Governments	2,303	2,677	—	
Navy Research	36,132	45,819	44,385	
Totals	\$4,272,401	\$4,425,696	\$4,375,327	\$3,826,000

a. Excludes foreign aid and relief expenditures as follows: 1948 — \$25,099,000; 1949 — \$15,490,000. Expenditure for Naval Home transferred to Veterans' Care & Benefits.

b. In addition, \$15,000,000 contract authority.

c. In addition, \$32,000,000 of contract authority.

d. "Pay and Subsistence of Naval Personnel" transferred in 1950 to Bureau of Naval Personnel.

e. In addition, \$576,546,000 of contract authority.

f. Included with Bureau of Ships for 1950.

g. Amount shown is salaries for Judge Advocate's office. Other salaries distributed to various units in 1950.

The expenditures for the Air Force cannot be segregated from those of the Army for the year 1948 and 1949. There are given, in Table XLV, in lieu of trend data, the appropriations to the Air Force for the fiscal year 1950, together with the budget estimates of expenditure in the fiscal year 1951.

TABLE XLV

APPROPRIATIONS, 1950, BUDGET ESTIMATES, 1951, AND
RECOMMENDED EXPENDITURE FOR THE
UNITED STATES AIR FORCE

(Thousands)

Item	Appropriation 1950	Budget	
		Estimate 1951	Proposed, 195X
Construction of aircraft and related procurement	\$1,100,000 ^a	\$1,575,000	
Special procurement	125,797	90,000	
Acquisition and construction of real property	5,445 ^b	45,000	Not
Maintenance and operations	1,143,858	925,000	dis-
Military personnel requirements	1,201,000	1,250,000	tributed.
Claims	2,847	500	See
Research and development	233,000	120,000	Table
Air Force Reserve	77,630	70,600	XLVII.
Air Reserve Officers' Training Corps	11,677	9,400	
Air National Guard	114,690	107,000	
Salaries and expenses, administration	57,242	58,400	
Contingencies	15,200	25,500	
Miscellaneous	2,345	138,600	
Totals	\$4,090,731	\$4,415,000	\$4,013,000

a. In addition, \$1,922,755,000 in contract authorizations.

b. In addition, not to exceed \$50,000,000 may be transferred and merged with this appropriation, in the discretion of the Secretary of Defense.

Viewing the defense establishment data in overall, it should be noted that the House subcommittee reduced Army and Navy budget requests, and increased that of the Air Force, as follows:

Army budget requests reduced	\$214,041,000
Navy budget requests reduced	114,479,000
Total reductions	333,520,000
Air Force budget requests increased	209,067,000
Budget requests for Air Force contract authorizations increased	577,755,000

The subcommittee's explanation of the reductions was as follows:¹⁶

The committee felt that reductions could be made in all branches of the National Military Establishment in certain fields such as civilian personnel, civilian and military travel, subsistence, clothing, and equipage, transportation, economies and price trends being taken into account. It was felt that the Air Force was no exception and reductions below the budget were made in these fields; but, of course, an over-all increase had to be made above the budget in view of the accelerated program.

This explanation of the overall increase in the Air Force appropriation goes back to the approval previously given by Congress to the 70-group air force program. In their work on the 1950 appropriations, the Congressional committees were evidently under the impression that the goal of air strength represented by this program was to be approached with due expedition. However, in the budget for 1951, it is stated that the Air Force will be organized, in that year, into 48 groups and 13 separate squadrons, approximately its present strength.¹⁷

Nevertheless, the Air Force appropriations and authorizations offer the principal prospect of a cumulative or "snowballing" growth of defense costs. According to the data given in Table XLI above, the expenditures of the Army are being tapered off most, since the 1950 bill provides only \$220 million to liquidate prior contracts and has no new authorizations. The Navy comes next, with new authorizations falling some \$150 million below the cash provided to liquidate prior contracts. In sharp contrast is the authorization to the Air Force to enter into new contracts for a total of \$1,992,755,000, as against \$875,000,000 of cash for liquidating prior contracts. Plainly, the total defense expenditure will continue to rise in future for this one reason alone, unless there is to be a leveling off of the Air Force expenditures. Such leveling cannot occur while the new authorizations continue to bear the present relation (nearly 2½ to 1) to the cash payments on prior contracts.

The amounts in the House Bill for pay and subsistence reveal a singular degree of inflation, relative to total personnel, in the case of the Air Force in contrast with the other two services. The data are given in Table XLVI:

¹⁶ *Ibid*, p. 13.

¹⁷ *The Budget of the United States Government for the Fiscal Year 1951*, p. M29.

TABLE XLVI

TOTAL PERSONNEL, AND HOUSE APPROPRIATIONS FOR
PAY AND SUBSISTENCE, 1950

Item	Army	Navy	Air Force
Total personnel, military and civilian	1,071,136	886,271	582,215
Total pay and subsistence, 1950 House Bill (Thousands)	\$1,703,350	\$1,398,269	\$1,054,550 ^a
Average pay and subsistence per person	\$1,562	\$1,578	\$1,811

a. From *Hearings on Air Force section of 1950 appropriation bill*, p. 439.

While language used in the different titles of the House Bill may have certain shades of difference of meaning, by and large the terms "pay" and "subsistence" mean the same things in all branches of the service. The higher average allowance for the Air Force was not produced by the "flying pay," which was estimated at about \$52.5 million for 1950. This is a subject which could well have further explanation.

The problem of the future cost of national defense is the most important single aspect of the federal finances. Its solution involves decisions in two separate areas: the first area is that of foreign policy and the international scene generally, where an appraisal must be made of the trend of events and circumstances toward peace or war. Too great emphasis cannot be laid upon the need for utmost objectivity and reliability of the data supporting these top level policy decisions. The Hoover Commission's task force emphasized a point in this connection which had already become generally known:¹⁸

Testimony was presented to the Committee that in the spring of 1948, a mistaken intelligence estimate, prepared by a departmental intelligence agency, stimulated recommendations — which if followed — might well have had serious consequences. Fortunately, in this instance, the Central Intelligence Agency and other intelligence groups correctly evaluated the available information in good time.

The second area is that of organization and management of the defense establishment. At whatever level or state of military activity and preparedness the decisions arrived at in the foreign policy

¹⁸ Task Force Report on *National Security Organization*, p. 4.

area may decree, there is still great and continuing need for accomplishing the determined result at the lowest possible cost. The Hoover Commission's task force, cited above, said the following:¹⁹

The Committee failed to find in the military establishment a sense of cost consciousness or a general realization of the vital importance to our national security of utmost conservation of our resources.

This task force indicated three principal categories of possible economies:²⁰

These may be summarized as follows:

The first is savings resulting from a sound relationship between our national policy needs and our military strength. Strategic plans cannot, of course, be made rigidly or with a fine degree of accuracy. It is not easy to determine exactly what is necessary and what is not. Military establishment expenditures, however, must be as closely as possible related to our real security needs. While a reasonable margin of safety must be provided, every excessive air group, Army division, or naval task force that we acquire or keep in operation beyond our proper needs results in pure waste and adds heavily to our national cost.

The second broad category of possible economies is in improvement in the military establishment's methods of doing business and in more efficient utilization of military and civilian personnel. Careless and variable budgetary practices are among the reasons for unnecessary costs in our defense establishment.

The third category is the one usually cited as the area most susceptible to savings. This is the field of excessive duplications. It involves such things as cataloging and identifying material, inventorying, standardizing specifications, and removing wasteful duplications and overlapping by joint use of facilities.

In each of the fields of possible economies, the mechanisms for accomplishment now exist or are being created but they must be used more effectively. This calls in the first instance for instilling a spirit of the vital need for economy into the minds of those responsible for those functions, as well as proper recognition to those who assume and successfully carry out these important tasks.

This broad survey of the categories of possible economies is not documented by the task force or by the Hoover Commission in specific amounts. Mr. Hoover said, before the Senate Committee on Armed Services in the course of the hearings on the National Security Act amendments:²¹

¹⁹ *Ibid*, p. 5.

²⁰ *Ibid*, pp. 49, 50.

²¹ *Hearings before the Senate Committee on Armed Services*, 1949, p. 131.

I requested the chairman of the task force engaged in this investigation to estimate what the savings might be, if all the reforms proposed were adopted. His guess was \$1,500,000,000 annually in money or money's worth.

Yet the report of this particular task force avoided reference to the subject except in general terms, but it did go rather directly to the heart of the cost issue in the following:²²

Greater efficiency within the National Military Establishment obviously can effect substantial savings, but reduction of the military budget by major amounts can be effected only by reduction in the size of the military establishment, which is a matter of high policy and not organization or administration.

There is no clue to the distinction intended between the "substantial savings" and the "major amounts" mentioned in the foregoing extract from the task force report. The amount suggested by Mr. Hoover may fall within the former category of substantial savings through adoption of improved budgetary and other administrative practices. In any event, it is clear that the approximation of possible economies suggested by Mr. Hoover was based on the assumption that improvements would be introduced in the business management of the armed services akin to, or similar to, those which had been proposed in other reports for the civil departments and agencies. That is, it was anticipated that in addition to reforms of budgetary method and procedure, there would be changes in procurement, in the making and handling of records, in the management of transportation costs, and also better coordination of hospital facilities and medical services. In view of the evidence that has been produced relative to loose procedures, uncoordinated spending, and even extravagance, in the operations of the military services, it does not appear extreme or excessive to conclude that a saving of 10 percent in overall cost would be possible, as a result of the numerous recommendations that were made in the Hoover Commission's task force report.

Accordingly, a projection of the reasonable peacetime costs of the military establishment, based on the appropriations for 1950, would be as shown in Table XLVII, assuming that in each branch of the service an overall reduction of 10 percent in current operating costs would be attainable.

²² *Op. cit.* p. 46.

TABLE XLVII

ADJUSTMENT OF APPROPRIATIONS FOR THE MILITARY
ESTABLISHMENT TO AN OVERALL REDUCTION OF
10 PERCENT
(Millions)

Service	New Cash 1950	10 Percent	New Cash Requirement	Cash to Liquidate Contracts	Total
Army	\$4,262	\$426	\$3,836	—	\$3,836
Navy	3,584	358	3,226	\$ 600	3,826
Air Force	3,348	335	3,012	1,000	4,013

The percentage reduction obviously cannot apply to the funds required for liquidation of prior contracts. In the 1950 bill the Navy was given \$643 million for new contract authorization. It is assumed that this would level off at about \$600 million. Likewise, for 1950 the Air Force was granted \$1,992 million in new contract authorization. The House subcommittee stated that this amount was proposed in order to speed up the development of the 70-group program. It now appears that there will be a leveling off at a 48-group program. But at whatever size the stabilization occurs, the new contracts thereafter would be in an amount necessary to replace wrecked and obsolete planes. The appropriation in 1950 for liquidation of prior contracts was \$875 million. It is assumed here that eventually this requirement would be \$1,000 million annually. The House Bill for 1950 made no provision for Army contract authorization, and it is assumed here that little or none will prove necessary in future.

In using these figures it should be apparent that they are anticipated appropriations, not actual expenditures. The actual outgo would be slightly different but when an agency is operating, year by year, on its current appropriations, the variations between appropriation and expenditure will not be large.

The National Security Council and The National Security Resources Board. These agencies were established by the National Security Act of 1947. The Council's function is to advise the President with respect to the integration of domestic, foreign, and military policies relating to the national security. The function of the Board is to advise the President on certain specific matters

having to do with effective mobilization of resources in the event of war and with certain economic readiness measures against the contingency of war.

The Hoover Commission's task force comments on these agencies are significant:²³

The National Security Council is probably the most vital element in the entire security structure. On its proper and effective operation the success of the whole system depends. While it has made considerable progress, especially in recent months, it does not yet measure up to the needs of the times. . . .

The Council's weakness in long-term planning has been largely due to the pressure of emergency problems. It is now taking steps toward fulfilling its important long-range responsibilities. It is still not in a position, however, to give the National Military Establishment that degree of basic guidance which the military must have if a sound balance between the size of the military establishment and the needs and capabilities of the Nation is to be achieved. . . .

The National Security Resources Board . . . has lacked clarity of basic purpose and firmness of direction. . . . It has failed to develop a sufficiently clear grasp of its own duties and potentialities. But more important than these internal shortcomings, is the fact that it does not seem to have been strongly supported or adequately utilized. The functions of the Board are not clear to those departments and agencies whose services it should use.

The future expenditures for these agencies are anticipated at approximately the current levels, namely \$200,000 for the Council and \$4 million for the Board.

Atomic Energy Commission. Heretofore, the budget data submitted by the Atomic Energy Commission have been in consolidated or lump-sum form, and even in the presentation for the fiscal year 1950 the House subcommittee was obliged to comment again, as the same committee in the preceding year, on the deficiencies in the data submitted. In consequence, no complete picture of the Commission's financial operations is available. The budget for 1951 contains the following statement as to prospective requirements:²⁴

Unless there arise major new developments for the production of fissionable materials and weapons, it is expected that the peak in requests for new construction will have been reached in 1950, with a substantial decrease in construction to be authorized thereafter. While costs for plant and equipment will increase from 1950 to 1951, obligations for new projects

²³ Task Force Report on *National Security Organization*, pp. 75 and 91,

²⁴ *Op. cit.*, p. 73.

are expected to fall off from \$504.5 million in 1950 to \$192.3 million in 1951.

The budget estimate of total costs incurred shows totals of \$698 million in 1950 and \$825 million in 1951. But the decline of further commitments referred to in the preceding citation from the Budget will contribute to an estimate of about \$600 million as the total of obligations to be incurred in 1951.

Even now, the strictly military part of the activity is less than one-half of the total. Chairman Lilienthal stated, in the 1950 hearings, that as of June 30, 1949, the total expenditure would be about \$4 billion, of which, at most, \$700 million will have gone for items which can only be used as weapons. He added:²⁵ "All of the rest of the major part of the expense may be attributable to weapons, if that is all that we can see in the world, but as we get into energy, more and more of this material becomes available for energy not associated with weapons."

It was testified in the 1950 hearings that by the end of the fiscal year 1950, two-thirds of the construction program would be completed. As the remainder of this program is completed, there should be, obviously, a substantial drop in the total expenditures. The House subcommittee was particularly critical of the Commission's policies in housing construction, town operations, and scale of rentals. It emphasized the importance of effecting economies in all of these lines, including an adjustment of rentals to a better relationship with the investment cost.

For the long-range program, assuming that major construction will be completed shortly after 1950, it would appear that the annual cost of the Commission's operations should not exceed \$500 million. Should industrial uses be developed, a source of revenue would be provided which would offset a considerable part of the cost.

Stockpiling. The stockpiling program was summarized in the hearings on the 1950 appropriation bill as follows:²⁶

The war needs (i.e., for all materials on the stockpile list) have been estimated at 12.4 billion dollars; the proportion to be stockpiled at 3.8 billion dollars; 4.4 billion dollars out of domestic production; and imports from protected areas 4.2 billion dollars.

²⁵ *House Hearings on Independent Offices Appropriation Bill, 1950, Part I, p. 1088.*

²⁶ *Hearings before the House Subcommittee on Appropriations on the National Military Establishment Bill for 1950, Part 1, p. 149.*

A year ago the goal of the stockpile program was said to be \$3 billion, but it has apparently now been raised to \$3.8 billion. The House subcommittee wrote as follows on the program:²⁷

The stock-piling program has been moving forward at a quite satisfactory pace, and the committee believes that good progress has been made in building up our reserves of strategic and critical materials.

The present value of the inventory is not disclosed in the reports or testimony. Some idea of this amount may be had from the following record of expenditures and appropriations:

TABLE XLVIII
EXPENDITURES AND APPROPRIATIONS FOR STOCKPILING
(Millions)

	Fiscal Years		
	1948	1949	1950
Actual expenditure	\$99	\$299	—
Appropriations			
New cash			\$275
Contract authority			250
Cash to liquidate prior contracts			250

The House Subcommittee explained that the present rate of procurement was such that all of the items contracted for would not be delivered in the fiscal year 1950. It was therefore not necessary to provide in full for the contract authority granted in 1949. Taking into account the total of new cash and of contract authority, the annual rate of spending will evidently be somewhere between \$500 million and \$600 million. At this rate, the present inventory goal of \$3.8 billion will be attained by 1954 or 1955. Thereafter, unless the goal is raised still further, the operations should be on a roll-over basis. That is, some components of the stockpile are not sufficiently durable for permanent storage and must be sold for industrial use before deterioration occurs. The sale of such components should provide the funds for their replacement, without requiring large additional appropriations, assuming ordinary business methods and no violent price distortions. In the long-range program outlined here, it is assumed that no provision will need to be made for this last-named contingency.

²⁷ House Subcommittee on Appropriations, *Report on Treasury and Post Office Bill, 1950*, p. 9.

Foreign Aid and Occupation Costs. The original schedule of foreign aid under the Marshall Plan contemplated the termination of financial grants to the participating countries by 1952. Administrator Hoffman stated, in his argument against a reduction of the appropriation for 1950, that he could assure smaller requests later, and an overall total of less than the \$17 billion originally scheduled, if the amount he was then requesting were granted. While there will no doubt be pressure from various sources to continue these payments, the position taken here is that the program should be terminated as originally scheduled. Accordingly, it is assumed that there will be no occasion for further expenditures under the category of foreign aid in the long-range program outlined here.

The same conclusion applies to the costs of maintaining our armed forces in occupied countries. It is assumed that in the next three or four years there will be manifest a sufficiently realistic and constructive foreign policy as to bring about satisfactory settlements of the difficulties and problems which now appear to justify our armed occupation of various former enemy countries. Accordingly, the long-range program envisaged here makes no provision for expenditure of this sort.

North Atlantic Treaty Arms Aid. No judgment can now be made regarding the effectiveness of the mutual defense assistance program in accomplishing the purposes for which it was designed. As yet there has been no test, and no one has formulated a statement of how much defense is necessary to assure the North Atlantic Community against aggression. It is evident, of course, that this country must be the principal source of such military equipment as is to be provided during the initial stage of the defensive preparations. It has not been said, as yet, that a large outlay for this purpose must be carried, henceforth, in the federal budget. In the absence of definitive pledges and open commitments to this end which are generally known and accepted, it is assumed that the present rate of appropriating (more than a billion dollars a year) will soon be terminated, and that such contributions as may be required as our share of the cooperative undertaking can presently be met by allocations from the regular defense budget. Accordingly, no provision is made here for future arms aid.

Conclusions:

1. Defective internal organization and direction of the Veterans' Administration has led to unnecessary costs.
2. In the hospital program there has been wasteful construction, unnecessary duplication of facilities, and a serious dilution of service standards.
3. Future costs of national defense constitute the most important single aspect of federal finances; its solution depends on the determination of foreign policy and the internal organization and management of the defense establishment.
4. Army and Navy expenditures under contract authorizations are being curtailed, but the Air Force new authorizations are $2\frac{1}{2}$ times the payments on prior contracts, and thus present opportunity for snowballing defense costs.
5. Average pay and subsistence per person is much higher in the Air Force than in the two other services.
6. Under the proposals of this program, war-connected costs of the federal government may be reduced from the 1949 level of \$30,983 million to \$20,748 million in 195X.

Recommendations:

1. The internal organization of the Veterans' Administration should be tightened, and costs for administrative, medical, hospital and domiciliary services should not exceed \$800 million.
2. The unnecessary scope of the veterans hospital construction program should be corrected, and its operation held within \$100 million.
3. Current operating costs of each branch of the defense service, exclusive of funds to liquidate prior contracts, should be reduced by at least 10 percent, this to be accomplished by better management, correction of duplications, more efficient business methods, etc.
4. Once construction is completed, it would appear reasonable that annual costs of the Atomic Energy Commission should

not exceed \$500 million; revenue from the development of industrial uses should be applied to offset part of the cost.

5. By 195X stockpiling, on the basis of present goals, should be on a rollover basis, not requiring additional appropriations.
6. The foreign aid program should be terminated by 1952 as originally planned.
7. The settlement of present international problems, and the development of a sufficiently realistic and constructive foreign policy should render occupation costs unnecessary within the next several years.

CHAPTER 11

GOVERNMENT BUSINESS ENTERPRISES

The introduction to the Hoover Commission's Report on Federal Business Enterprises, provides an appropriate factual summary of the extent of federal business activities:¹

There are about 100 important business enterprises which the Federal Government owns or in which it is financially interested. These concerns engage directly or indirectly in lending money; guaranteeing loans and deposits; writing life insurance; the producing, distributing, and selling of electric power and fertilizers; the operation of railways and ships, the purchasing and selling of farm produce; and the smelting and sale of metals. The Government's direct investment in these enterprises is in excess of \$20 billion, and there are further authorized commitments to supply about \$14 billion to them. In addition, the Government guarantees directly and indirectly about \$90 billion of deposits or mortgages, and the life insurance written by Government approaches \$40 billion.

Here is one of the most serious aspects of big government. It is the competition of the government with its own taxpaying citizens, using the funds which they have provided for the purpose of engaging in lines of business directly competitive, in many cases, with private business, yet subject to none of the cautions and restraints which private business must observe if it is to remain solvent. The immense scale on which this competition has developed is revealed by the summary data in the foregoing extract from the Hoover report.

The agencies engaged in the numerous forms of business are classified by the Hoover Report as follows:²

1. Lending, guaranteeing, and insurance enterprises
2. Electric power and irrigation enterprises
3. Miscellaneous business enterprises.

In earlier chapters, reference has been made to the operations

¹ The Hoover Commission, *Federal Business Enterprises*, p. 1.

² *Ibid*, Table of Contents.

related to electric power and irrigation. Here the principal attention will be given to the lending, guaranteeing, and insurance agencies.

The Hoover Commission's task force on Lending Agencies, in a discussion of the necessity of lending agencies, says the following:³

The philosophy of promoting self-help should be the guide in determining what governmental functions are necessary and how they are to be administered. So far as it is possible, the necessary functions should be kept close to the people through local and state governments where political responsibility begins and is most amenable to the desires of the citizenry. The strengthening of local civic consciousness will generally produce strong and responsible political leadership, and it will serve to maintain the balance needed in a private economy between public and private activities.

The foregoing is an apt phrasing of the general viewpoint and purpose of the program of re-allocating services and resources of which this chapter is a part. The government activities under consideration here are among the most insidious forms of encroachment developed by big government. Under a cloak of benevolence, there is piled up a mountain of direct and contingent obligations to crush present and future taxpayers. There is large-scale competition with these taxpayers on very one-sided terms, the advantage being entirely with government. And there is a continual expansion of controls over the private economy.

The Hoover Commission task force lists four major classes of operation germane to the activities of the federal lending agencies. These are:⁴

1. Direct grants and other subsidies given with no prospect of financial recovery. An example cited is the failure to charge the full cost of borrowed money advanced by the Treasury to various agencies.

2. The lending activities, which involve the placing of Government funds in private hands, directly at risk. On this practice the task force report comments as follows:⁵

The present lending activities of the Government are products of the "depression emergency." Many of them are distinctly inconsistent with the

³ The Hoover Commission, *Task Force Report on Lending Agencies*, p. 19.

⁴ *Ibid.*, p. 5.

⁵ *Ibid.*, p. 21.

traditional philosophy of American Federal Government, particularly where direct lending is concerned. Even in times of economic difficulty, the direct lending function has been performed most adequately through existing private institutions, in a manner consistent with our traditional philosophy of Government. The most effective Government assistance was that which stimulated rather than that which replaced.

3. The loan-guaranty activities, which involve contingent obligations on the part of the Government to place public funds in private hands at risk under certain circumstances.

On this point the following comments from the task force report are apropos:⁶

In general, the Government's guaranty that it will make good the default of a private borrower, with respect to repayment of a loan obtained from a private lender, should not be given unless the funds borrowed have been applied or are to be applied to performance of a governmental function. The funds are so applied if they are ear-marked for expenditure to provide facilities or to defray costs under a Government procurement contract. They are so applied, also, if they are to be paid over to a Government agency as all or part of the purchase price of property sold to the borrower by the agency. . . .

We do not consider it desirable or appropriate that the Government guarantee the loans of private borrowers as part of a program of social improvement. The Government's guaranty that it will make good the default of a private borrower with respect to repayment of a loan obtained from a private lender should not be given under circumstances which contemplate:

- a. That the funds will be employed for other than productive purposes, or
- b. That the borrower is a member of a class which generally, or over-all, will probably not be able to meet the obligation to repay.
- c. The Government's guaranty should be given only for a fee which is adequate, over-all, to sustain the guaranty program.

There has been merging and overlap of programs concerned with all of the four procedures. Further confusion has arisen from employment of lending, loan-guaranty, and loan-insurance devices as integral parts of other activities of the Government, such as defense and other large-scale procurement, disposal of surplus property, and federal encouragement or sponsorship of housing and slum-clearance projects, and large-scale public works construction. The task force report adds:⁷

⁶ *Ibid*, pp. 54, 55.

⁷ *Ibid*, pp. 5, 6.

Thus we find the direct subsidy, the lending, the loan-guaranty, and the loan-insurance devices employed primarily in two ways. First, they are used as direct means of extending Government financial assistance to individuals, to private enterprises, or to locally owned public projects. Second, they are used as auxiliary devices to assist the Federal Government and its own programs, or in extending integrated aid to individuals and their enterprises.

The Hoover Commission did not accept all of the recommendations of its task force on the subject of lending agencies and others engaged in related forms of giving aid at public expense. For example, the task force recommended that the Reconstruction Finance Corporation be put into liquidation at the earliest possible time, despite the recent extension of the charter by action of Congress. The Commission suggested, instead, that the Corporation be reorganized to guarantee loans by commercial banks. The task force had proposed that the Federal Reserve Banks be authorized to guarantee business loans made by private banks.

Such a guarantee, by whatever agency made, is completely preposterous. The task force arguments for the prompt liquidation of RFC are cogent and compelling. Neither this group nor the Commission has made any kind of case at all for guarantee of business loans. In fact, the suggestion is directly counter to all that the task force and the Commission have written in criticism of federal lending practices.

In view of the detailed discussion of the functions of the numerous federal agencies which deal with lending, and insurance or guarantee of loans, by the Hoover Commission and its task force reports, it is not necessary to cover the same ground here. These reports emphasize the confusion and disorganization that have been produced by the creation of so large a number of these agencies, with too little attention to coordination, clear definition of responsibilities, or alternative means, public or private, of providing the service. The above-mentioned reports contain numerous suggestions for simplifying the situation through merging of related agencies, through liquidation of others, and through the development of better managerial practices. There was a division among the members of the Hoover Commission with respect to some important proposals in the general field of government business enterprises. The point at issue was the

propriety of recommendations involving policy matters, illustrated by the proposal that there be established a system of national mortgage discount banks, and also by the suggestion that the relative advantage of sale of electric power at the bus-bar versus public construction of distribution lines, be considered. One minority group implied that the governmental purposes, as indicated by legislation, were, in effect, sacrosanct. The dissent by Commissioners Acheson, Pollock, and Rowe contains the following:⁸

The Commission here makes sweeping recommendations as to basic national policies embodied in Federal statutes. This, we think, is beyond its province. Entirely aside from any interpretation of the statutory mandate which Congress has given us, this report is the only one of the series of reports where the Commission has abandoned its self-imposed discipline to refrain from comment on the wisdom of statutory enactments.

It should be clear, however, that very little progress can be made in the direction of reducing the scope, the burden, and the dangers of over-sized government unless there is to be, somewhere, a challenge to the wisdom of statutory enactments which ordain certain lines of action to be governmental purposes. The ostensible benevolence of the many welfare purposes upon which government has embarked is a handy instrument for continual extension of the sphere of the state in its relations with the people. This extension must be checked if the American system of government and the American system of free, private enterprise, are to be preserved. Nowhere is there a greater threat to these institutions than that offered by the federal business enterprises.

The most serious, broad concern is therefore the best ways and means of halting the growth of these enterprises. This is, indeed, a policy issue of the greatest significance, and its application must be developed through all of the educational and other means that can be devised. Meantime, from the particular standpoint of the present discussion, and assuming reasonable success in the broad endeavor to turn back this specific tide, it is necessary to consider what may be the net budget impact of the grand total of these enterprise operations. Table XLIX presents the actual record for the years 1948-1949, and the estimates for 1950-1951.

⁸ Hoover Commission Report, *Federal Business Enterprises*, p. 92.

TABLE XLIX
EFFECT OF GOVERNMENT CORPORATION TRANSACTIONS
ON THE BUDGET
(Millions)

	Fiscal Years			
	Actual		Estimated	
	1948	1949	1950	1951
Net budget expenditures in checking accounts	\$165	\$1,774	\$2,509	\$2,069
Net budget expenditures from general and special accounts	127	66	137	156
Net effect on budgetary expenditures	\$292	\$1,840	\$2,644	\$2,225

Source: *The Budget of the United States Government for the Fiscal Year 1950*, p. 1042; *Ibid*, 1951, p. 1147.

These figures suggest an aspect of the current budgetary deficit situation which has not had the attention it deserves. The matter can be pointed up by comparing the totals in Table XLIX with the actual and estimated deficits.

NET COST OF GOVERNMENT CORPORATIONS
(Millions)

Year		Deficit
1949	\$1,840	\$1,811
1950	2,644	5,533
1951	2,225	5,133

From this comparison it can be seen that there would have been no deficit in 1949 if all government corporations had been on a self-support basis. The losses of these corporations, or their net cost to the Treasury, can be said to account for almost half of the estimated 1950 deficit, and for about 40 percent of the estimated 1951 deficit.

The Commodity Credit Corporation and the Reconstruction Finance Corporation together account for some 90 percent of the drain on general taxpayers through the Treasury. These corporations are operating within the terms of substantive laws, but the nature of the commitments which these laws impose is not well understood. It is expected, for example, that the Reconstruction Finance Corporation will buy more than a billion dollars of housing mortgages in the current fiscal year. The chief reason appears to be that the law has set too low a maximum on the

interest rate, and the original private investors, it is anticipated, will unload a large volume of mortgages. And certainly, the financial aspects of the present loan program for the support of agricultural products should be promptly reviewed and overhauled.

Pending the success of any efforts that may be made to bring about a curtailment of the scope and the financial obligations of the government enterprises, the prospects of substantial reduction of the net load on the general taxpayers are not too bright. The Hoover Commission task force which reported on Lending Agencies suggests a standardization of certain definitions, and in this proposal there may be the germ of a procedure whereby the government's net burden may be reduced and held in some degree of control. These definitions follow:⁹

Lending. Lending means to assist financially, but only for a period of time of definite duration after which the amounts advanced for assistance are to be repaid, together with an appropriate charge for their use, determined on an objective basis. The basis underlying the charge for use should be related to, but not necessarily determined by, the open money market. A lending activity is self-sustaining; the aggregate of the interest charges to borrowers should be sufficient to cover (a) interest costs, (b) expenses of administration, and (c) collection losses.

Loan insurance. Loan insurance is a self-sustaining financial activity. Through charges against the participants in the program, it prorates the collection losses and expenses of administration, and each class of borrowers makes good the default of its unsuccessful or irresponsible members. The cost of defaults is a cost of the program. There should be no cost to the Government, even if the Government sponsors the insurance program, and the establishment of eligibility standards should be predicated upon this principle.

Loan guarantee. Loan guarantee is an assistance form in which the Government exposes itself to the risks of having to bear all collection losses occurring in the underlying lending program. No subsidy is contemplated by a genuine loan guarantee program. The Government's loan guarantee programs should provide for the creation of a sufficient guarantee fund established by pro rata collections from the participants in the program.

In this series of proposed definitions there is a clue to a change of policy which, if adopted, would gradually diminish the net budget cost of programs of the above types. This clue is that the charges under loan, insurance, or guarantee programs should be enough to make them self-supporting, in which case there would

⁹ *Op. cit.*, p. 10.

be no net budget cost to be carried by the general taxpayers. That would introduce the element of accounting and fiscal honesty. A program that purports to be one of lending, insurance, or guarantee which does not spread the total costs among the participants really involves, in some degree, a subsidy to the members of the favored group. A scale of charges that would fairly cover all of the costs, and thereby spread these costs over the particular group involved in a given program would no doubt diminish the attractiveness of that program. The thing that makes government lending, insuring or guaranteeing attractive and popular today is the fact that there is usually more or less of a concealed subsidy in it. And here is the key to the consolidation and expansion of political power through these programs.

The Hoover Commission's task force was emphatic in insisting that there should be no commingling of the various types of aid program in the same agency. That is, the same agency should not provide subsidies, make loans, engage in loan insurance, and so on. There was equal emphasis, also, upon the importance of bringing all subsidies fully into the open so that the people could be aware of them and of their cost. In this connection it was pointed out that the price support operations of the Commodity Credit Corporation are actually subsidies, although they purport to be a form of non-recourse loans on farm commodities. Both the task force and the Commission itself recommend that the procedure now used to supply the Corporation with funds be changed. Under this procedure, the Corporation gives its notes to the Treasury in exchange for funds. When the funds have been exhausted, the notes are cancelled. The recommendation is that the Corporation be supplied through direct appropriations.

In one respect it is incredible that the most prosperous nation in the world should have so little faith in the economic system that has made its prosperity, wealth, and economic progress possible as to permit the introduction of as many programs of support, assistance, subsidy, and control as it has. The concept that government can support the economy and carry it to higher levels is completely inconsistent with the concept of free, private enterprise as the mainspring of economic advance. Government economic supports of any kind are really hindrances to progress, and the

fact that there continues to be progress is a tribute to the capacity of the enterprise system to surmount handicaps rather than a testimony to the efficacy of the supports. Obviously, however, the burden of the aids and supports can become so great as to negate the dynamics of enterprise.

There is no prospect that the re-allocation of service responsibilities and fiscal resources which has been offered in this study can go so far as to alter radically and promptly the pattern of subsidy and support that is now so widespread. The most that can be hoped for is some diminution of the anesthesia of paternalism that has lessened the innate capacity of the people to think clearly on this matter. A useful first step in this direction is to put the various aid programs fully into the open to be identified as such. Even this degree of improvement must come slowly, for many changes of substantive legislation are required. Assuming an acceptance of such a redirection of policy, it will be possible to contain the net budget costs of these programs within endurable limits. For the present, and in the absence of fiscal guides other than those so inadequately indicated in the budget, it is suggested that a long-range goal for the average net budget cost of the mass of subsidy and loan programs should not exceed \$1 billion.

* * * *

Conclusions:

1. Government economic supports of any kind are hindrances to progress and their burden can become so great as to negate the dynamics of enterprise.
2. Government is in business in large-scale competition with, and at the expense of, its taxpayers.
3. There are about 100 important federal business enterprises in which the total investment exceeds \$20 billion. The federal government guarantees about \$90 billion of deposits and mortgages, and writes about \$40 billion of life insurance.
4. The federal government continually expands controls over the private economy but its own business enterprises are subject to none of the restraints which private business must observe, and they operate in confusion and disorganization,

with neither adequate coordination nor clear definition of responsibilities.

5. The lending activities of the federal government are in effect concealed subsidies; this is the key to the consolidation and expansion of political power through these programs.
6. Nowhere is there a greater threat to the American system of government and of free, private enterprise than that offered by the federal business enterprises.

Recommendations:

1. The growth of federal business enterprises must be halted.
2. The Reconstruction Finance Corporation should be promptly liquidated.
3. Further retrenchment is possible through the merging of related agencies, the liquidation of others, and the development of better managerial practices.
4. However, the real answer is a matter of policy: charges made in the loan, insurance or guarantee programs should be enough to make them self-supporting, so there would be no net budget cost to the taxpayers.
5. If this basic principle is not adopted, at least the element of subsidy in these programs should be brought into the open so the people can be aware of them and their costs in taxes.
6. All federal enterprises should be placed on a self-supporting basis as soon as possible.
7. Until such time as remaining federal enterprises become self-supporting, the average net budget cost of the mass of subsidy and loan programs should not exceed \$1 billion.

CHAPTER 12

FEDERAL GOVERNMENT TRUST ACCOUNTS

The program of re-allocation of tax resources and service responsibilities between federal and state governments requires, first and foremost, that the states assume certain services now being paid for by the federal government either directly or through the device of a grant-in-aid, and that they also have a sufficient increase of the taxable capacity at their disposal to provide for the support of the services recommended for transfer to them.

Such a program involves a careful delimitation of the obligations to be assumed by, and of the revenues to be available to, the federal government, in order to avert, in future, a creeping federal encroachment upon the nation's overall taxable capacity. Such a development could, in time, so seriously impair once more the ability of the states to do the job assigned to them as to bring about again the evil of federal domination and decline of the states.

The subject of the trust accounts is related to this general program, particularly in its long-range aspects. The accumulation of large amounts of federal debt paper in trust funds creates an impression of financial strength which is illusory, not real. Nevertheless, the existence of a debt which is believed to be an asset presents the temptation to establish benefits on a scale which will eventually require large drafts on general revenue. It is proper, therefore, to examine this matter.

DESCRIPTION OF THE TRUST FUNDS.

The Annual Report of the Secretary of the Treasury regularly carries the following standard definition of a trust account.¹ The substance of the definition is quoted, but illustrations cited of the various classes of trust account receipts are omitted.

¹ *Report of the Secretary of the Treasury for the Fiscal Year 1948*, p. 395.

Trust Accounts.—Trust account receipts represent moneys received by the Government for the benefit of individuals or classes of individuals and are used for purposes specified in the trust. Moneys held in trust, being payable to or for the use of beneficiaries only, are not available for general expenditures of the Government. There are several classes of trust account receipts the beneficiaries under which may be either individuals or groups of individuals. The accounts may represent (a) moneys received directly from or for account of individuals; (b) moneys collected as revenues and held in trust; (c) proceeds of grants from the general account of the Treasury in pursuance of treaty or other obligations; (d) deposits, donations, or contributions for specified purposes; and (e) deposits to be held until appropriate disposition thereof can be made.

The above definition is no doubt technically correct, and if the federal government's trusteeship were confined, in all cases, to the custody and management of funds or other assets coming into its possession by gift or bequest, or as an incident to some other direct relationship with the parties involved, there would be no problem of importance in the present connection. The government's trust operations go much farther in some cases, and involve the collection of large amounts of cash which, as cash, does become available for general expenditures, notwithstanding the technical impounding in a trust fund.

The distinction here referred to may be clarified by noting a three-fold classification of the federal trust accounts, based on the character of the assets in the accounts.

First, there are various small trust funds which have been received as bequests or gifts for various purposes. In each case there is a certain principal which produces income for the purposes of the trust. As of 1949, the Treasury managed the investments for the following trusts of this character.

TABLE L
TRUST AND SPECIAL FUNDS FOR WHICH INVESTMENTS
ARE MADE BY THE TREASURY

	Assets, June 30, 1949
Ainsworth Library, Walter Reed Hospital	\$ 10,287
Library of Congress	2,184,527
National Archives gift	17,267

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	Assets, June 30, 1949
National Cancer Institute gift — conditional	420
unconditional	2,621
National Institute of Health gift — conditional	90,836
unconditional	4,077
National Park Trust Fund	19,235
Pershing Hall Memorial	196,518
U. S. Naval Academy general gift	89,898
Total	\$2,615,686

Source: *Report of the Secretary of the Treasury*, 1949, Table 60. Text tables LI and LII are from the same source.

In each of the above cases, the assets held by the Treasury consist of (a) specific private securities comprising the original donation or other private securities purchased in the course of fund management; or (b) ordinary public marketable United States bonds, evidently comprising the original gift or acquired in the open market with cash which was at one time part of the trust corpus.

Second, there are numerous types of current receipts and payments of a trust character which do not involve the custody and maintenance of a large principal or corpus. Examples are the deposits of fees and other payments for services, from which payments will be made to defray the cost of these services when and as performed. The Library of Congress receives deposits in advance from subscribers to the catalogue service, and makes charges against these deposits as catalogue cards are printed and distributed. Other examples include receipts and payments by hospitals on behalf of patients, and by the armed services for their personnel at home and abroad. Accounts of this type are normally on a current basis, with annual cash inflow and outgo in approximate balance.

Third, there are the huge reserve funds, so-called, which have been built up in recent years for old age benefits, unemployment compensation, veterans' insurance, and civil service retirement. About 90 percent of the total assets of the trust funds of this general type consist of special debt issues. The distribution of assets between special issues and public issues of the debt, as of June 30, 1949, is shown in Table LI.

TABLE LI

ASSETS OF CERTAIN TRUST FUNDS FOR RETIREMENT,
RELIEF, AND REHABILITATION, AND AMOUNTS INVESTED
IN SPECIAL AND PUBLIC DEBT ISSUES RESPECTIVELY,
AS OF JUNE 30, 1949

(Thousands)

Fund	Total Assets	Investment in the Debt	
		Special Issues	Public Issues
Adjusted Service Certificate Fund	\$ 5,686	\$ 5,563	—
Alaska Railroad Retirement	3,523	3,447	—
Canal Zone Retirement	14,143	13,919	—
Civil Service Retirement and Disability	3,284,275	3,238,375	\$ 5,043
D. C. Teachers Retirement and Annuity	15,690	—	15,411
D. C. Water Fund	1,837	—	1,837
D. C. Workmen's Compensation	95	—	95
Old Age and Survivors Insurance	11,309,949	9,003,000	2,227,670
Railroad Retirement	1,799,115	1,720,000	—
Unemployment Compensation	8,182,417	7,340,000	798,332
Foreign Service Retirement	14,557	14,497	—
Longshoremen and Harbor Workers			
Relief and Rehabilitation	605	—	605
National Service Life Insurance	7,306,689	7,287,685	—
U. S. Government Life Insurance	1,440,053	1,318,000	—
Totals	\$33,378,634	\$29,944,496	\$3,048,777

The difference between total assets and investment in debt issues is to be accounted for by current cash receipts not yet invested on June 30, 1949, and by working cash balances in the accounts of disbursing officers.

This exhibit provides a test of the practical validity of the statement, in the Treasury's definition of a trust account quoted earlier, to the effect that moneys held in trust are not available for general expenditure. The meaning of the term "moneys" in the context of the definition clearly does not refer to the original money payments made by employees and their employers under the various programs for retirement, insurance, and in the case of civil employees, disability as well as retirement. That cash has been used for general purposes, as for current expenses during the period of deficit financing before and through the war period,

and for retirement of other debt in the short postwar period of budget surpluses. All that the term can mean is that the Treasury is not now free to sell the marketable bonds held, or to convert special issues into public issues and sell them, and use the funds so obtained for general purposes. Liquidation of the paper of either type held in the funds must be solely for the purpose of making payments to the beneficiaries of the particular fund involved.

The accumulation of the immense sums that are shown in some of the trust funds represents a peculiar kind of borrowing from the public. This is recognized in the budget tables² which show the receipts from, and payments to, the public. The statement of consolidated cash receipts and payments includes the amounts collected for the various trust account purposes; and by the advocates of greater emphasis upon consolidated cash budgeting, trust fund cash is put on the same basis as general fund cash receipts.

To complete the record of this special kind of borrowing from the public, there is presented in Table LII a list of the remaining institutions which have engaged in operations essentially of a trust character and which have transferred their cash receipts to the Treasury in exchange for special debt obligations.

TABLE LII

HOLDINGS OF THE TREASURY'S SPECIAL DEBT OBLIGATIONS BY OTHER TRUST INSTITUTIONS AS OF JUNE 30, 1949
(Millions)

Institution	Amount
Postal Savings System	\$1,949
Canal Zone Postal Savings System	3
Farm Tenant Mortgage Insurance	1
Federal Home Loan Banks	117
Federal Deposit Insurance Corporation	666
Federal Savings and Loan Insurance	95
Total	\$2,831

² In the Budget for 1951, such a table appears on page A117.

The characteristic which all of the trust funds shown in Table LI have in common is that they represent a variety of government programs whereby the several groups of beneficiaries are contributing during their working years in order to receive stipulated or scheduled payments upon retirement, or, in the case of the government insurance programs, in order that payments shall be made to the heirs of insured persons. The trust funds listed in Table LII have a different common feature, namely the accumulation of funds to be paid out under certain contingencies, or at demand in the case of the postal savings deposits. In both classes, government uses the excess of current cash receipts over current disbursements for its own general purposes, whether to cover budget deficits or to retire other debt. That is, government has borrowed and used the cash, and has committed itself to supply the equivalent at any time that drafts upon the trust funds may be required.

Prior to the inauguration of the social security programs in the middle 1930's, the accumulation of federal trust accounts was not large in the aggregate, and the "investment" procedure included, to a considerable extent, the market purchase of outstanding federal securities. The transfer of cash through the issue of special obligations was on a small scale. The first of such special issues appears in the public debt records for 1925, in the amount of \$95 million. The total rose to \$764 million in 1930, and dropped to \$291 million in 1931. From this low point the special issues rose to \$20,897 million at the end of February, 1946, when the public debt was at its highest point. Thus there has been, since 1931, a total diversion of excess cash receipts during the period of deficit financing, of \$20,606 million. With the emergence of budget surpluses, the excess trust account cash has been applied to the retirement of other debt. As Table LI shows, the great bulk of this diverted cash, for current use and for debt retirement, has been provided by the civil service retirement fund, OASI, railroad retirement, unemployment compensation, and the two insurance programs. Provision is made under each program for an accrual of interest on the principal of the fund, and this is done by delivering to the fund the appropriate amount of additional special issues. Since the budget estimate of

interest on the debt includes these accruals, there is available an equivalent amount of cash for other purposes.

The special debt issues held by the trust funds are not marketable. Hence in the event that cash disbursements in excess of current cash receipts were necessary at any time, it would be provided by selling some kind of debt paper to the public and using the cash so obtained to redeem a portion of the special issues. Thus the fund would have cash for meeting its obligations. An alternate, though rather remote possibility, is provision of cash for liquidation of the special issues by an increase of current taxation.

THE PROBLEMS INVOLVED

Significance of Debt Held in Trust Funds.

The first question to be considered is that of the propriety of this kind of borrowing. The defense is that if it is necessary to borrow, government may as well borrow the trust account cash for general purposes as to float larger public loans. Practically speaking, this is the only feasible procedure if there are contributions in excess of payments to beneficiaries. Otherwise the surplus cash receipts for trust account would pile up as idle government-owned bank deposits. This would produce in time a considerable strain on the banking system and on the economy as a whole because it would sterilize a large and growing total of purchasing power.

The viewpoint just stated is rather cynical, nevertheless. It assumes that the contributors are aware of the disposition being made of their payments. This is extremely doubtful so far as the vast majority of them is concerned. And it is by no means assured that they would cheerfully acquiesce in a diversion policy if they did know about it. They pay taxes, or insurance premiums, or contribute from their salaries as public employees, in the belief that in this way they are actually building a fund for their subsequent benefit. The fact is that, to the extent their contributions of premiums or payroll deductions exceed the respective current program outgo requirements, they are supplying cash for current purposes, or for debt retirement. The trust fund device merely means that, having used the cash originally paid in, the govern-

ment has promised to find other cash for benefit payments whenever it becomes necessary to draw upon the so-called funds. This aspect of the procedure is far from clear to most people. It would be most helpful to a correct understanding of the entire complex of taxing, borrowing, and provision of the various benefits if it were explained, frankly, that these various groups of contributors are being levied upon now for ordinary governmental needs, and that the ultimate discharge of the government's obligations with respect to benefits payable in the future will involve another round of financing transactions.

From the standpoint of debt management, it is not good policy to create a large amount of debt which is beyond Treasury control with respect to redemption or refunding. Such is the case as to the trust fund debt, for it is essentially a form of demand debt. That is, the government is committed to liquidate any portion of it that may be required for disbursement at any time. As already noted, this would require redemption either through increased tax levies or through flotation of a corresponding amount of other debt. The new borrowing, if used, must be done promptly, on demand, regardless of the existing market condition or state of receptivity to fresh government loans, and quite apart, too, from any other financing that might impend. To the degree that trust account cash has been used to retire other debt rather than poured into the hopper of current spending, it would be helpful as regards the liquidating process, for it would have reduced, by so much, the holdings of investors and thus would have contributed to a better market for new paper.

The problem of what to do with the excess cash receipts would disappear if there were no excess cash. The particular reasons for the excess differ somewhat according to the purposes of the specific programs. A factor common to all programs, however, is the policy of creating a reserve of assets against future payment requirements. In this respect the concept of a reserve held in trust against commitments maturing in the future has been transplanted from the private economy where it is valid, to the public economy where it has no validity. In the case of the programs for which the reserves are being accumulated, the government has assumed an obligation to make these future pay-

ments. The belief that government's ability to discharge this obligation is in any way strengthened by the fact that certain amounts of the government's own promises to pay are held in trust accounts is pure illusion. The amount of debt paper in a government trust fund merely measures the extent to which there is a commitment to increase taxes or to float debt publicly, when and if necessary. The fund's holdings do not in any way increase government's ability to levy higher taxes or to sell its debt paper. They are not assets in any real sense of the term. It was said above that application of surplus trust account cash to the retirement of other debt would tend to create market conditions favorable to the flotations that might be required to aliment the trust funds; but the same favorable condition would be created by levying taxes and retiring publicly held debt directly without the formality of passing cash through a trust account for that purpose.

Ultimate Burden of the Trust Funds.

In the most fundamental sense the only asset that government can have and depend upon for meeting any or all of its obligations is a sound, productive private economy that is strong enough to carry the load of government in addition to the necessary burden of costs connected with the private productive operations. Great Britain provides a current example of a private economy that is unable to carry the load of government that has been imposed upon it. They are realistic enough to know that there is no virtue in trust fund reserves to support their welfare programs. Actually, it is proving impossible for that country to endure the taxation needed to support these programs on a current cash basis, to say nothing of the additional taxation that would be required to build up huge fictitious reserves consisting of more government debt.

Additional confusion exists with respect to the purpose and reality of the federal trust funds because huge future commitments have been made under them without a clear understanding of what the ultimate total cost may be, or of who should pay for what, or when. No generalization regarding payment into the fund is fully applicable to all programs. In unemployment compensation, employers pay the whole cost except in two states which have provided for employee contributions. In the civil service retirement system,

employees and employer (the federal government) both contribute. In the government life insurance systems for veterans, the insured persons pay premiums and the government pays administrative expenses, carries premiums waived on account of total disability, and covers any additional policy obligations attributable to the extra hazard of war service. In OASI, employers and employees pay equal rates on taxable payroll.

Thus, except for unemployment compensation, there is, throughout, the principle that the beneficiaries should carry part of the cost of the benefits to be received by themselves, or by their heirs or dependents. This is a sound principle which should never be abandoned. The confusion over trust funds arises in the application of the principle of individual contribution. It has been assumed that this contribution can be made only by requiring that the individual payments be accumulated in a trust fund which is to be, in future, the source of his benefit payments. There is another way of correlating payments with benefits which does not involve large excess accumulations in trust, and which accords more realistically with economic facts. This alternative procedure, which is here recommended, can be understood more readily if stated in simple economic terms.

The several programs under discussion here together constitute a system of providing support, under certain contingencies, for non-worker members of the population. In any given year this support must take the form of the actual goods and services required for subsistence. It must be a diversion, to the use of these beneficiaries, of a certain portion of the current product. Except for the relatively small amounts of carry-over from previous production, the sole basis of support for all members of the community is the current product. Certainly no one can be supported today from next year's production.

The goods and services that are diverted to the current use of the several classes of beneficiaries must likewise be bought and paid for out of current income. The thing that has happened, and must inevitably happen, to the surplus cash receipts of the federal trust accounts demonstrates that it is impossible to store up purchasing power from one year against the requirements of future years. The non-negotiable debt paper in the trust funds must be

converted into current purchasing power in order to be used for paying trust obligations. This is merely an application of the elementary principle that income is a flow, and, like a river, it cannot be used to turn a wheel after it has passed through the flume.

To sum up: each year the beneficiaries of these programs will be entitled to certain goods and services as determined by the terms of the several programs, and they must receive from government, purchasing power sufficient to obtain them. Hence, each year the productive, income-earning members of our society must give up, in contributions or taxes, enough income to settle those claims.

A CASH-BASIS PROPOSAL

A current cash basis plan is proposed for the support of the several programs now operating on the trust fund device. It is the only available alternative to that device, and can be applied, although with variations, to each program. In general, the procedure would be as follows: first, determine the benefit outgo for the year, or for some period of years immediately ahead; and second, collect from those determined by law to be eligible for benefits under any program enough to cover the cash outgo, as ascertained by the estimates of cost. In practical operation, it would not be feasible to strike an actual balance, year by year, between collections and outgo. Minute changes in the tax rate year by year would be annoying, and variations in the volume of taxable wages would give rise to further complications. Hence, while the cash basis objective would not lead to further large accumulations of funds in excess of current payments, there probably would be some over-collection in good years, and some deficiency of collections in lean years. In view of the fixed character of the payment obligations, it would be necessary, and entirely consistent with the cash basis concept, to apply the excess collected in one period toward the deficiency of collections in another period.

Any excess of this character should be regarded as a working balance, or a contingency, or equalization fund. Whether it be held in cash, as part of the general treasury fund, or used to acquire outstanding government securities, is of minor consequence. In any event it would not be large, by comparison with existing accumulations, and it would be subject to more or less complete with-

drawal according to the current variations in receipts and payments, both of which would be affected by business conditions. It would be, in effect, a revolving fund for the equalization of current receipts and current outgo, with the period of turnover adjusted as well as may be to the economic cycle. As such, it would never contribute to the idea so closely associated with the present immense funds, that they constitute a treasure laid up for payment of future benefits.

Under cash-basis plans each program participant would earn his own right to become, eventually, a beneficiary. It is not necessary, indeed it is not realistic, to limit his acquisition of this right to his having paid money into a fund where, in some mysterious way, it is supposed to be earmarked for his future use. But it is essentially realistic to establish his right to benefits by relating his payments to the servicing of the current program requirements, just as a part of the output of his current productive effort is applied to the subsistence needs of present beneficiaries. Under a consistent, continuing program, each generation of workers will thus acquire title to their own benefit payments as they pass out of the group of employed workers, by having supported those workers who preceded them.

Old Age and Survivors Insurance.

The simplest illustration of a cash-basis plan is presented by the old age and survivors benefit system. Each year a certain sum will be needed to pay benefits. The amount that workers and their employers should contribute should be adjusted periodically, as explained above, to approximate the necessary outgo, having regard to cyclical variations of both receipts and payments. If they pay more, as they have been doing even under the low rate of 1 percent each on taxable payrolls, the surplus goes into general government funds for purposes other than retirement benefits.

Since the increase of the aged and their dependents will require larger annual benefit payments with time, the rate of current contribution must be correspondingly adjusted. In view of the immense excess above current benefit requirements that will be produced by the overall tax rate of 3 percent which became effective as of January 1, 1950, it is evident that after an immediate

downward revision of this rate to fit current cash needs, a considerable period would elapse before the rate would again be as high as 3 percent, even with some liberalization of benefits. Eventually, over a full generation of adjustment, the rate would move up further, and an approximate stabilization would be established when there had occurred a normal long-range balance between the insured aged and the insured workers. Each contributing worker would, under the cash payment plan, accumulate his own title to retirement benefits by having been assessed for the benefits of the workers who had preceded him into retirement.

In opposition to the cash-basis method, there is the contention of Federal Security Administration officials and others that the rates should be increased now in order to approach more closely to the level premium rates for such so-called insurance as determined by reference to actuarial principles.³ Were this done the current cash receipts would be enormously increased and the cash available from trust accounts for general government purposes would be a torrent rather than a moderate stream. This is inevitable in the early years of a comprehensive retirement benefit system, because, as noted above, the normal proportion of aged, retired, insured workers to the younger insured labor force can be reached only after a full generation of operation. The scheme is unfair to workers, employers, and the whole economy in the meantime because it would be really a special method of taxing for general purposes concealed in the guise of an accumulation toward future benefits. Its unfairness would be intensified by any increase of the rates.

Recognition of the taxation as against the benefit aspect of the OASI levies is seen in the following recommendation of the Council of Economic Advisers:⁴

³ The National Service Insurance System provides an illustration of what can happen under level premium rates. The law provides that the insured veterans shall pay premiums determined by reference to the American Mortality Experience Tables. This they have done. The Veterans Administration has found that these tables are obsolete, so far as concerns the mortality experience of the selected group covered by the national life insurance program, and a large proportion of the total amount paid in premiums has been refunded. There are many questions about this refund which have not been satisfactorily answered, but they require no answer here. The point is that an attempt to push up the OASI rates to a level estimated to be the equivalent of a level premium would create very quickly a large reserve, and by the same token would make available for other purposes an immense flow of cash.

⁴ *Economic Report of the President*, January, 1949, p. 76.

To have the optimum immediate anti-inflationary effect, payroll taxes should be increased by more than the increase in benefits. To have the optimum long-range stabilizing effect, the expansion of these programs should not be financed exclusively by payroll taxes. It should draw some support in future years from general budget sources.

In the first sentence of this passage it is clearly implied that the payroll taxes should be determined by reference to general economic conditions and objectives rather than to the program of benefit payments. The Council does not indicate just how an increase of such taxes would restrict inflation in view of the disposition that is ordinarily made of the cash receipts. Obviously, the only way the expected influence would be exerted would be through use of these surplus funds to retire bank-held debt.

The jug-handled nature of the Council's proposal to increase the payroll taxes as an inflationary control may be seen by inquiring what it would recommend in case a marked deflation were under way. The logic of its position would require that the rates of payroll tax be reduced under advancing deflation, but such a move would be untenable from the standpoint of the objectives of the benefit program.

The suggestion that general revenues be drawn upon to supplement the payroll taxes has often been made, and a provision to this effect has been in the law since 1943. That it could ever have been made indicates lack of clear understanding of all implications. First, it would be incongruous and inequitable to provide from general taxes, which are borne in some measure by all citizens, any part of the benefits which are paid only to a certain group, namely the covered, fully insured workers. True, it has frequently been proposed that the entire working population be covered by the program, but in view of the elaborate recording and accounting involved in the operation of the present system, the feasibility of such extension is open to serious question.

Second, the use of general revenues should logically involve complete review of the benefit formula. This formula includes earning rate and length of covered employment, and is definitely weighted in favor of small incomes. The greater the amount of general revenue support, the weaker is the case that the beneficiaries have paid for their own benefits.

Third, the consequences of any extended general tax support

should be carefully considered from the standpoint of its effect on federal-state tax relations. The wellbeing of both the aged dependents and the active workers is bound up with the preservation of the American constitutional system and free, private enterprise. They can have more, at less cost, this way than in any other. It would be extremely short-sighted to promote so great an expansion of federal taxation to pay the costs of any of the retirement or insurance benefits as to undermine the fiscal independence and responsibility of the states.

One of the values of a complete cash-basis contribution plan is its inherent safeguard against disguised inroads on the general treasury for the specific purpose of benefit payments. There should be no general fund support. When the benefits to be paid in any year are too great to be borne by those contributing to the specific program, they are too great for the general economy, and certainly too great to be subsidized by taxpayers outside the plan. Even were the program to become universal, it would still be better to have it supported fully and recognizably by an "ear-marked" tax, than by funds from an unrelated general revenue system. Under the cash-basis plan, there would be no need for drawing on general revenues, since current contributions would always be adjusted to meet the requirements of current benefit payments. It is therefore recommended that Section 902 of the Revenue Act of 1943 be repealed.

Civil Service Retirement.

The civil service retirement system could likewise be put on a current cash basis of support. It is true that there is involved here a much smaller segment of the labor force than in the covered private industry under OASI. The principle is the same, however. In this case government has contributed to the retirement and disability benefits of the civil employees, and such contributions would be in order equally under a cash basis plan of financing.

Veterans Life Insurance.

The Hoover Commission recommended that the government life insurance systems for veterans be transferred to a new government corporation organized for this purpose. The Commission was no

doubt correct in asserting that this would provide better management of veterans' insurance. It did not, however, follow the logic of its evidence and argument to conclusion. In criticism of the existing operation of these insurance systems the Commission said:⁵

The work-load per employee is far less than the number of premium payments, conversions, and individual contacts should warrant. This is illustrated by the comparison made by our task force between an agency branch office and a company of similar size. With about the same number of employees, the company handled five times as many policies as the branch office, sent out many more premium postings and letters, and indeed exceeded the performance of the branch office on all of 10 types of operation.

The conclusion from this comparison is that the veterans' insurance business would be better and more economically handled if it were transferred to private insurance companies. The device of a new government corporation is only a halfway step in the proper direction, according to the above evidence. The important point in the present connection, however, is that under private management the inflow of premium and investment receipts in excess of matured policy disbursements would be invested, partly in ordinary marketable government securities and partly in approved private securities. This excess cash would not be available, as at present, for general government purposes. Even if the business were to be transferred to a new government corporation, there is no reason why its investment policy should be more circumscribed than that of a soundly managed private insurance company, and hence no reason for siphoning all of its cash surplus into the general treasury.

Unemployment Compensation.

The unemployment compensation program presents the greatest difficulty of all with respect to the issue of the validity of a trust accumulation. The purpose of this program is to make possible certain payments, in lieu of wages, to persons who are unemployed. Funds are provided by a tax on payrolls to be paid by employers. (Alabama and New Jersey also require an employee contribution.)

The matter is complicated by the fact that the relative amount

⁵ Hoover Commission Report on *Veterans' Affairs*, pp. 11, 12.

of unemployment is not constant, but is subject to wide variations over the business cycle. In boom years it will be small, both absolutely and in relation to the labor force. In lean years it will rise, and as the one serious, prolonged experience of the 1930's indicated, it may attain massive proportions.

In theory, the employers who are subject to the system pay the tax into a fund which is to be drawn upon to pay the benefits. In practice, all of the states have introduced one form or another of reducing the tax below the formal rate of 3 percent under so-called "merit-rating" devices. The justification for these reductions has been the large excess of cash receipts over disbursements during the war and postwar periods of high employment. The average rate of tax on employers in the states with merit rating declined from 1.81 percent in 1942 to 1.2 percent in 1948. The total reduction in revenue, as the Federal Security Agency puts it, or the total saving to employers as the latter would view it, was \$3,571 million through 1947.⁶

The position taken in this program is that the entire responsibility for the operation of unemployment compensation programs should be turned over to the states. A reservation, already noted in Chapter 9, is that the formality of a federal tax be retained, but that full credit be allowed for all taxes paid as long as the state maintains an unemployment compensation system and complies with certain federal standards. Such an arrangement would not disturb the essential present facts, for the states are now in charge of, and responsible for, virtually all substantive details of application and operation, although the federal security administrator has a considerable degree of supervision and control, the leverage for which is afforded by his authority to withhold a state's grant for administrative expenses, and even to refuse certification of the funds collected by the state and deposited with the Treasury. A particularly sore point has been the *agio* retained by the federal government from the .3 percent tax which must, in any case, be paid regardless of the state's own allowance under merit rating. From 1938 through 1947, this portion of the payroll tax produced \$1,313,580,000. Its original purpose was to provide a fund from which federal grants to the states for administrative

⁶ *Social Security Yearbook*, 1947, p. 39.

purposes could be made without encroaching upon the benefit fund proper. In the same period the total of such grants was \$548,-828,000 leaving a profit to the Treasury of almost \$800 million.⁷

The principal issue of importance in connection with the proposal for complete return of the unemployment compensation system to the states is that of the ability of the several states to maintain a satisfactory level of benefit payments; and, as a related issue, whether they would be equal to the problem of managing reserves held as trust funds. Frankly, the first of these questions has not yet been put to a test. Even so, there would be no adequate answer without some clear understanding as to the real purpose of this program and a judgment as to what constituted satisfactory fulfillment.

On this point, it needs, perhaps, to be emphasized that the program cannot be regarded as more than a cushion against the moderate waves of unemployment which come from time to time. The limitations on the duration of benefit payments indicate that the system has never been intended to pay benefits to anyone over an indefinite period. If there were to be, by some grave misfortune, a recurrence of unemployment on a massive scale, the accumulations would be cleaned out.

As for the rest of the story, it is clear that the position of the several states would not be greatly different, whether under the present or the proposed plan. The amounts collected in each state are supposed to apply to unemployment benefits payable in that state. Each state is thus independent in that respect now, and would be under the proposed change. Moreover, each state has a considerable latitude for increase of the payroll tax rate, for the maximum under existing law for benefit purposes is 2.7 percent, as against a general average today of 1.2 percent. It should be said that all of the states do not have the same latitude for rate increase, since many of them now levy rates considerably above the national average, but there is none that does not have some leeway. And finally, there would be no hindrance or restriction upon the levy of a rate, temporarily, above the present maximum. In fact, some states now authorize maximum rates above 3 percent.

The reasons for advocating complete transfer of this program

⁷ *House Hearings on Labor-Federal Security Bill*, 1950, pp. 487, 488.

to the states are: First, it is a program which they are now handling, in very large degree, and which they are fully competent to handle entirely on their own. It is in accord with the general philosophy of this re-allocation program to put back into state and local hands the things that can be done well there, and the unemployment compensation system is one of those matters. Second, it will relieve employers of the burden of an extra federal tax under which they have contributed, merely in their capacity as employers and as an incident of a benevolent program, some 800 million dollars into the federal treasury for general purposes, above administrative costs allowed. Third, it will eliminate further increments to a large federal trust fund and thus lessen by so much the cash thereby made available for general federal purposes. In this connection it is recommended that the present state balances in the so-called reserve be allowed to remain there, since the cash which created them has long since disappeared in the general federal hopper. When and as circumstances require, the states should draw down these balances for benefit purposes. In future, under the plan recommended here, each state would manage its own funds, and if there were in any period an excess of payroll tax collections over disbursements, the proper state authorities would determine the manner of investment, subject to appropriate state legislation. The creation of a reserve in trust at the state level is not the same thing, in all respects, as a federal trust fund. True, there is the same issue of reality if the state were to borrow the cash by giving its own bonds to the fund. But it is not restricted to this policy, for it could buy ordinary federal bonds, or the bonds of other states with good credit standing, or private securities approved for savings bank and trust investment. In all of these ways the excess cash would not go down the drain of general state expense, but would pass again into the regular investment channels of the community. There would be no illusion about such a reserve, at the state level, for the assets held in the fund would represent valid claims against the income and taxable capacity of other governmental units and of the private economy. The most illusory aspect of a trust fund is encountered when the governmental unit responsible holds nothing but its own promises to pay as assets.

SUMMARY

1. *Tax and Debt Relationship.*

This whole subject of the government trust accounts has a certain significance today from the standpoint of overall tax burdens, and if present tendencies are not checked, it will have far greater significance eventually. The collection of amounts above what are needed for current program disbursements is a kind of excess taxation. The supposed storage of these surpluses in trust accounts is seen to be illusory, being the shadow rather than the substance of purchasing power. Yet interest is accrued on these intangible special debt obligations, and that accrual is included in the budgeted total for interest on the debt. Accordingly, the general taxpayers are levied upon by so much more, and since it requires no cash to settle the interest payment on special trust fund debt, there is opportunity to apply this cash to general expenditure purposes. And finally, if it should become necessary to apply part of the trust fund principal to the payment of its program commitments, a procedure ordinarily involving flotation of substitute debt with the public, the interest and redemption of this publicly held debt will involve taxes. Beyond these manifestations of taxation in connection with the laying up of treasure for future benefits, there is also the question of using general revenues for partial support for some program.

2. *The Illusion of the Trust Fund.*

There has been some confusion about this matter of taxation in relation to the benefits of the social insurance programs. It derives in considerable degree from the different meanings assigned to terms and procedures. The workers who are paying OASI taxes on their wages believe that they are actually laying up treasure for their future use. What they are actually doing is first, establishing a record of employment and earnings, and second, supplying cash for the general purposes of government, to the extent that their current payments exceed the sums needed for program disbursement. It is relatively easy to persuade employees to agree to higher payroll taxes, and even to foment among them demands for such increases, because of this inherent misunderstanding. Inasmuch as the workers who will have provided the surplus cash receipts

which have given rise to the special debt obligations in the trust fund will have attained retirement age before liquidation of these obligations is likely to become necessary, they will bear only a small part, if any, of the additional taxation required to service and redeem the new debt. But the next generation will carry this additional burden and it will also be paying its own payroll taxes at the same time. The matter can be summed up by saying that while there will be at least three phases of taxation, as indicated above, the extent to which any given person or group of persons will pay more than once is not determinable in any precise fashion.

3. *Cash and Carry.*

The significance of the government trust funds for the long-range program of service and tax re-allocation lies in the character of the policies which are to shape the programs that now give rise to trust account transactions. The issue between further additions to trust accounts and the pay-as-you-go method is clear. It is the question of continuing, for a considerable period, to make special levies on certain groups for general purposes, including debt retirement, or of adjusting these levies to the current costs of the general programs, and of making increases in such levies according to the rise of the current benefit payments. If the trust funds are allowed to expand, the contributors should at least understand precisely what this means. And if these funds should rise to very large amounts, the illusion of vast resources is likely to produce powerful pressures for large increases of benefits. On the other hand, with the cash-basis recommended, any illusion as to the source of the benefits currently being paid, will be prevented. The money for support of the non-workers will come from current income, just as the goods and services for their subsistence will come from current products.

* * * *

Conclusions:

1. The long-range aspects of certain trust funds involve using general tax revenues for the payments of program commitments.
2. Payments into trust funds in excess of amounts paid out

are used for general government purposes or reduction of marketable debt.

3. The trust fund concept is not valid at the federal level. The collection of amounts above what is needed for current program disbursement is a kind of excess taxation.
4. Too great a resort to trust fund programs is dangerous. It is not good debt policy or debt management to create a large amount of demand debt which is beyond Treasury control in respect to redemption or refunding.
5. Large drafts upon general federal revenue are likely to be required: to redeem the debt held by the trust accounts, and, in the case of old-age and survivors insurance, to finance benefit payments when their requirements exceed the funds available for that purpose.

Recommendations:

1. Payroll taxes for old age and survivors insurance should be on a pay-as-you-go basis, and Section 902 of the Revenue Act of 1943 providing for partial subsidization of OASI out of general revenues should be repealed.
2. The veterans insurance program should be executed through private insurance companies.
3. Complete responsibility for the unemployment compensation systems, including the management of all current tax receipts, should be released to the states.
4. The budgetary practice of showing appropriations to the Railroad Retirement Board equivalent to taxes collected from railroads and their employees, should be discontinued, and these funds should be transferred to the appropriate trust fund in the same manner as is done in the old age and survivors insurance program.

APPENDIX

REVIEW OF MATERIALS ON INTERGOVERNMENTAL FISCAL RELATIONS

The problem of intergovernmental tax coordination was born with the Union, for, from the beginning there were three levels of government for the people to support. But when government spending was young, taxes were low and the problem was relatively inconspicuous. It was almost possible for each level of government to have independent sources of income. For example, prior to World War I, the federal government lived mostly on customs duties and tobacco and liquor excises. The states and localities mainly supported themselves by business and property taxes respectively. But government spending grew up with the first World War; the traditional division of sources no longer supplied enough revenue for federal expenditures. And by the early 1930's public spending had come of age. Competition for revenue at different levels of government was producing serious duplication and conflict.

The problem of tax coordination was officially recognized in 1933. In that year the first Congressional report on the subject of federal-state fiscal relations was prepared by a Subcommittee on Conflicting Taxation of the House Ways and Means Committee, under the chairmanship of Fred M. Vinson. Although the report was confined to a picture of then-existing duplications, it nevertheless led the way for subsequent inquiries.

It was also in 1933 that the Interstate Commission on Conflicting Taxation began work on what was to be the parent research study in a long effort to improve intergovernmental fiscal relations. This Commission grew out of the Interstate Assembly, a group of official delegates from the states who met early in the year to promote uniformity and harmony of action between federal and state governments in areas where disharmony was a threat to the

public welfare. It developed that the immediate threat and the most urgent problem was the conflict of federal and state taxation. The Assembly therefore appointed a Commission whose main objective was:¹

Reduction of the tax burden — first, by reduction of government expenditures, federal, state, and local . . . second, by the development of a more orderly, equitable tax system . . . and, third, by eliminating so far as possible . . . multiple assessments and collections from the same sources . . .

The Interstate Commission made both an immediate and a long-term approach to the problem. It was early recognized that a first, urgent step was action for a limited separation of tax sources. On the other hand, it was also realized that the long-term problem involved more than the technical separation and integration of tax sources.

Two years of factual and exploratory research, under the final direction of James W. Martin, contributed to the proposals for immediate action. The federal government was to relinquish taxes on gasoline and electrical energy for the exclusive use of the states. Exclusive use of tobacco taxes and volume taxes on liquor were to be reserved for the federal government. Preferential use, that is for revenue purposes, of the taxes on beer was also to be retained by the federal government, while the states and localities were to impose such taxes mainly as a regulatory device. In regard to general sales taxes, although the staff report contained a substantial review of retail sales, gross income and federal manufacturers' excise taxes, the Commission announced that it had not found any plan which it was prepared to offer. A division of revenue from the income tax was proposed. This was to be effected by a graduated formula for crediting state personal taxes against federal income taxes. And the loss of federal revenue from the credit was to be replaced by certain technical changes, such as lowering exemptions, which would increase taxable income.

The long-range tax proposals followed the same pattern, but were less specific. Three alternative plans were presented. These were based on assumptions of extreme, mild, and minimum central-

¹ Interstate Commission on Conflicting Taxation, *Conflicting Taxation*, The 1935 Progress Report, p. 1.

ization of government function. Included were the individual and corporate income taxes, death taxes, general sales taxes, and the tobacco, liquor and gasoline excises. The first two plans emphasized exclusive federal use or federal administration of these taxes with sharing or crediting devices to assure state and local revenue. The third plan, reserving the bulk of tax administration and revenue to the states is herewith outlined:

FEDERAL

Individual income taxes: apply only on personal income over \$10,000.

Corporate income taxes: apply only on corporate income over \$10,000.

Death taxes: preferential use and administration.

Tobacco taxes: exclusive use.

Liquor taxes: exclusive use of volume taxes.

STATE

Individual income taxes: exclusive taxation of personal income under \$10,000; permissive taxation of income over that.

Corporate income taxes: exclusive taxation of corporate incomes under \$10,000; permissive taxation of income over that.

Death taxes: adjusted credit provisions; state supplements.

Liquor taxes: Liquor license taxes for state and local use.

Gasoline taxes: exclusive state and local use.

Sales taxes: voluntary development of uniformity.

However, the long-term problem involved more than tax allocation. At the heart of it lay a question of basic political policy: Is governmental centralization or decentralization the more desirable? That is, should the problem of conflicting taxation be solved by encouraging centralization — which had already taken an extreme form when the Commission issued its report; or, should efforts be made to solve it in a manner consistent with the American tradition of local responsibility and freedom of action?

The Commission considered that a great degree of centralization, although an effective solution to tax conflict, would mean “fundamental departure from the theory on which our fiscal system was based.”² An equally successful solution predicated on the principle of decentralization required comprehensive information on the three-level distribution of governmental functions. But the lack of such information had already severely limited the work of the Commission. It thus became apparent that the answer to intergovern-

² *Ibid.*, p. 183.

mental tax problems depended largely "on working out a sound policy regarding the proper allocation of various governmental activities among the units of governments."³

However, the sphere of the Commission's work did not extend to the determination of this fundamental question. It therefore proposed that the Interstate Assembly appoint a Tax Revision Council with members representing federal, state and local viewpoints in public finance, to study this issue of centralization versus decentralization. The Commission believed that "there should be deliberate consideration by representatives of all levels of government on this question."⁴ It was anticipated that the Council would continuously investigate the intergovernmental allocation of functions, and for this purpose a special committee was established within the Council. But unfortunately there is no record of the deliberations or findings of that body. In fact the active work of the Commission itself seems to have ended with this pertinent recommendation in its Progress Report of 1935.

Although the next major study of intergovernmental fiscal relations was not undertaken until 1941-1943, there was continuing interest in the subject during the intervening years. The Tax Policy League considered the problem grave enough to warrant the time of its entire program at the 1937 symposium. In general the papers presented posed questions and problems regarding tax administration and reciprocity, sharing devices, and control of local finance. There was no formal conclusion or recommendation of the conference as such, although individual speakers occasionally made specific suggestions. Some discussions touched on the redistribution of functions, and one practical comment deserves repetition:⁵

... it would be unfortunate if the cause for reallocation of government functions was financial need rather than the administrative inability of the ... unit now in jurisdiction. At all events, whether (it) can ever assume major proportions in central-fiscal readjustment will depend of course upon the success with which one category of vested interests, the public officials now in jurisdiction, can be dislodged.

In 1939 the Municipal Finance Officers Association suggested a

³ *Ibid.*, p. 11.

⁴ *Ibid.*, p. 174.

⁵ L. Laszlo Ecker-R. "Basis of State Sharing" in *Tax Relations Among Governmental Units*, Tax Policy League, (1937) p. 103.

plan of action embracing all levels of government but designed to balance the financial resources of the localities with the cost of services demanded of them. When this received no response from state and federal governments, a second report on local fiscal needs was made in 1940. This carried the recommendation that the President appoint a committee to make a comprehensive study of three-level-government fiscal relations.⁶ This was done; Harold M. Groves, Luther Gulick, and Mable Newcomer were appointed, and in June 1941 the Committee on Intergovernmental Fiscal Relations came into being. Its exhaustive report,⁷ submitted in June 1943, and still the standard reference in this field, traces the development of intergovernmental fiscal problems and reviews the arguments for and against various solutions.

In general attitude regarding the coordination problem, this voluminous study took what it called the middle ground between the "strong centralizers" and those who favored the status quo. However, if the "strong" were deleted from the phrase, mid-way might not then be applicable to the Committee's stand. Although the Committee did not advise the federalization of government functions, it accepted the trend in that direction and, far from criticizing the causes, utilized them as a base for its overall approach.⁸

Whether we like it or not, the trend toward centralization is likely to go on irresistibly. The great fiscal resources of the Federal Government, with its large taxing and monetary powers, its superior strategic position in managing the economic system as a whole, the growing urge for minimum standards (of state and local services), and the interest in uniformity with developing interdependence, all point toward centralization.

The strategic position of the federal government for "managing the economic system as a whole" is the *raison d'être* of functional finance. And to such fiscal policies the Committee gives appreciable

⁶ To aid this committee by representing the viewpoint of local government, a third report was prepared for the Municipal Finance Officers Association by Thomas H. Reed in 1942, the essence of which was this: the localities should retain their traditional functions and should have sufficient, unrestricted revenue for them; but, since there is no where else for them to obtain additional income except from taxes laid and collected by their senior partners in government, this assistance should take the form of general-purpose grants.

⁷ The Committee on Intergovernmental Fiscal Relations, *Federal, State, and Local Government Fiscal Relations*, 78th Congress, 1st Session, Senate Document No. 69, submitted by the Treasury Department, June 23, 1943.

⁸ *Op. Cit.* p. 180.

emphasis. Its overall approach includes recommendations for the use of tax devices, public spending, and "creative" debt as instruments of fiscal policy for social and economic purposes. These were countercyclical measures proposed in anticipation of a postwar situation in which unemployment and idle plant capacity would become a serious problem. Under such circumstances the Committee felt that the government would "have to play a prominent role in keeping productivity at high levels," and that it should "underwrite . . . a high level of economic opportunity and as full use of resources and plant capacity . . . as possible."⁹ Various measures to close the savings-investment gap and maintain a high consumption economy were suggested:¹⁰

1. Use of taxes and other procedures to redistribute income ;
2. Actions to make incomes, as paid out by business, more nearly equal ;
3. Actions to reduce inequality of income by varying dollar buying power ;
4. Measures to reduce the social pressure to save ;
5. Government spending to balance excess savings ;
6. Measures to increase private-investment opportunity.

This series of proposals is most significant. In the first place, the greatest emphasis is on a redistribution of income by fiscal manipulation. This is a distinctly social purpose and the validity of its inclusion in a study of intergovernmental fiscal relations may be challenged on that basis. But the very fact of its inclusion testifies to the Committee's adherence to the tenets of functional finance and the mechanisms of a controlled economy. In the second place, it leaves no question as to the Committee's preference for an economy based on public investment ; for, measures in the first five points could so operate as to prevent not only the increase, but even the preservation, of the "private investment opportunity" mentioned in point six. Indeed, this position is overtly taken:¹¹

. . . it seems possible that a federal investment program will not only have to compensate for underinvestment in private industry, but on occasion, for the inability of States and localities to continue normal debt-creating operations.

In addition to public investment techniques, the role of the federal government in spending and in intergovernmental relations

⁹ *Ibid.* p. 362.

¹⁰ *Ibid.* p. 364.

¹¹ *Ibid.* p. 367.

was to be strengthened by broadening the Social Security and the federal aid programs. The Committee felt that the geographic maldistribution of income and the pressure for new revenue for state and local tax systems could be most effectively corrected by the further development of the federal income tax coupled with a well-ordered system of federal grants-in-aid.¹² In regard to the latter, the Committee made its report the occasion for presenting a special case for federal aid to education, although the direct relevance of this purpose to better intergovernmental fiscal relations may be questioned. Nevertheless, the Committee recommended that a national minimum status for elementary education be secured by equalizing federal grants, and that federal scholarships insure the adequate development of talent through higher education.

The Committee summarized its recommendations in the form of action programs for each level of government.¹³ On the whole, close to two-thirds of these dealt with general fiscal matters such as those already mentioned, and problems of legislation, administration, standards, controls, and uniformity of governmental accounting. However, even those recommendations dealing with taxation are notably general in character, for example, ". . . more effort on Federal-State collaboration in the administration of overlapping taxes;" also, "Develop . . . rules of uniform income-tax procedure (and) promote the adoption of such rules looking toward single administration of a relatively uniform State and Federal income tax." A further example of generality, and a rather abstruse one, is this statement:¹⁴

If indeed there is any valid reason for taxing business as such at all, it seems that the relative place of business taxation in our tax system is too large and that this form of taxation should be "deemphasized."

On the other hand a number of suggestions are of an over-refined, technical nature; such as, "Amend the income tax law to make State income taxes deductible on an accrual basis . . ." and "Disallow sales taxes as a deduction in Federal income tax practice."

¹² *Ibid.*, p. 12.

¹³ *Ibid.* pp. 41-45.

¹⁴ *Ibid.* p. 19.

The specific tax suggestions, by level of government are herewith briefly outlined. There was little separation of sources to make for intergovernmental independence. It will be noted that the federal government was to take the lead as well as precedence, the states were to "collaborate," and the localities were to receive the hand-me-downs. In addition, however, the discovery of "some" new source of local revenue was recommended to "preserve and restore" local autonomy.

FEDERAL

Individual income taxes: cooperative administration, with state taxes to become more of a supplement to the federal tax; state taxes to be deductible on an accrual basis; elimination of the application of community property laws to federal tax.

Business taxes: Tax undistributed corporate income at same rate as applied to distributed income; give partial credit to corporation for dividends paid; de-emphasize business taxes: "a good case can be made for exclusive (federal) taxation of business . . . with the States sharing in the revenues," and state and local withdrawal from the field in favor of a "new streamlined uniform centralized system."¹⁵

Death taxes: single federal administration or single joint administration with federal determination of taxpayer's liability to the states; credit for state taxes paid, of 50 percent of federal tax liability on the amount of net estates not exceeding \$100,000, and 25 percent on amounts exceeding \$100,000 with specific and insurance exemptions of \$20,000 each.

Gift taxes: reduce exemptions, extend federal credit as in death taxes, integrate with death taxes and coordinate federal and state levies.

Tobacco: federal-collection and state-sharing; for example, increase federal cigarette tax 2¢ a pack and distribute on a per capita basis weighted for urban areas on condition that states and localities withdraw.

Liquor: abandon license taxes but retain license itself.

Stock transfer taxes: forbearance, but potential exclusive federal use.

Payroll taxes: increase federal credit to 100 percent in unemployment tax.

Payments in lieu of taxes: to localities for federal properties therein.

Securities: eliminate tax-exemptions.

STATE

Individual income taxes: cooperative administration and uniformity, integrated with federal system.

Business taxes: withdrawal in favor of centralization and shared revenues.

¹⁵ *Ibid.* p. 21.

Death and gift taxes: integration of both taxes, and, by crediting devices coordinate with federal taxes.

Motor-vehicle taxes: greater consideration in sharing with cities.

Sales taxes: apply to contracts on government orders.

Property taxes: tighten exemptions; relax ceiling and uniformity requirements for freer local use.

LOCAL

Property taxes: use more freely; tighten exemptions; improve and make special assessments; supplement with a rental tax on occupiers.

Sales taxes: apply only as a last resort, and then with exemptions.

Payments in lieu of taxes: from federal government on federal properties.

Despite the length and detail of its 1943 report, the Committee felt its work was not complete, plans for a more comprehensive inquiry and more original research having been abandoned because of the war. Some of the basic data, however, have since been brought closer to date by the Treasury Department. "Federal-State Tax Relations," completed by the Division of Tax Research in July 1947 was designed to supplement the earlier study. It accounted for developments over the intervening years and tabulated areas of conflict, but carried no policy recommendations. It was one of a series of factual reports made by the Treasury in connection with postwar tax revision.

During this period from 1943 to 1947, there were a number of postwar tax plans developed. Probably the best known were the Twin Cities Plan, the Ruml-Sonne Plan, that of the Committee for Economic Development, and the two-volume program of the Committee on Postwar Tax Policy. For the most part these plans were restricted to federal taxation. However, the Committee on Postwar Tax Policy devoted a chapter in its 1945 report to federal-state relations. And it is worth recording, for where previous study groups had dealt with the results of conflict and overlapping and suggested treating the symptoms by revenue-sharing and grants-in-aid, this Committee recommended correcting the cause.¹⁶

¹⁶ Committee on Postwar Tax Policy, Director of Research, Harley L. Lutz, *A Tax Program for a Solvent America*, Ronald Press, New York 1945, pp. 230, 238-9. (Some suggestions were also made regarding separation of sources: exclusive state use of death and gasoline taxes; exclusive federal use of tobacco taxes; possible separation of liquor taxes by federal taxation of manufacture and state taxation of sales.)

The real difficulty is not so much with overlapping as such, but with the burden of the two taxes on the same base at the rates presently imposed. The really effective remedy is to reduce overall governmental costs.

The federal-state fiscal situation has been unduly complicated by the extension of federal grants . . . the advantage of a system of grants-in-aid is illusory.

Any proper program designed to solve the problem should begin with a consideration of functional responsibilities . . . appropriate allocation . . . (lies) at the root of the problem.

The Committee on Postwar Tax Policy thus crystallized several interrelated attitudes which, as will be seen later, were given some emphasis by developments in 1947 and 1949.

The Council of State Governments has been one of the most active organizations in the field of intergovernmental relations. Its work has spanned the entire period here under review: from 1933 when it was in the background of the Interstate Commission on Conflicting Taxation, to 1949 when it furnished the task force report on federal-state relations for the Hoover Commission. Its general points of view on intrastate relations, grants-in-aid, and separation of tax sources are herewith summarized.

In 1946 the Council published *State-Local Relations*. Its thesis was that because of the general legal and administrative relationships of the states to their localities, and their greater financial resources, they were responsible for the fiscal strength and stability of the localities. Although the Council recognized that a transfer of functional burdens and change in legal restrictions could alter these relative positions, such action was not recommended. It was merely noted that the transfer of "some" local functions to the state would improve both the service and the local fiscal position.

The Council felt that the distribution of service-performing and revenue-raising functions was essentially one problem within one governmental mechanism — a state-local, integrated whole. Therefore, because local administration was preferred to transferring functions, and because state fiscal capacities were greater, the localities "should not be expected to meet their growing fiscal needs from their own resources."¹⁷ Thus the case was developed for more and better state-aid. In turn, the success of *that* aid depended not only

¹⁷ Council of State Government, *State-Local Relations*, Chicago (1947) p. 128.

on the states' own fiscal resources, but upon "a well-ordered program of Federal grants to the states."¹⁸ If state aid failed then the answer was to be "direct, continuous, large-scale Federal grants to localities."¹⁹

In regard to allocation of taxes, the Council made its recommendations through the 1947 report of its Tax Committee. This advised as much a separation of sources as possible: for example, exclusive federal taxation of aviation gasoline and state taxing of highway gasoline; federal collection and distribution to the states of tobacco taxes; exclusive use of admission and amusement taxes by the local units along with service charges such as through parking meters. Other recommendations were: modernization of federal estate and gift taxes and extension of substantial credit; payments in lieu of taxes on federal property; and development of equalizing grants to the states "eliminating requirements for earmarking state funds."²⁰

On the general question of grants-in-aid, the Council has somewhat emphasized a proposal which had been made some years earlier by Thomas Reed in his study, *Federal State Local Fiscal Relations*.²¹ This was to the effect that stimulating grants to the localities be minimized and that more general-purpose grants, similar to the English block grant be made. In *State-Local Relations*, the Council recommended such grants, either without specification or with broad specifications only, in order "to avoid exercising too rigid an expenditure control over localities."²² It is interesting to see this idea developed in connection with the maintenance of jurisdictional sovereignty, for it recognizes that the main disadvantage to grants-in-aid are the strings attached to them.

In fact, this was one of the prime concerns of the Governors Conference of 1947, where the question of federal grants to the states was given serious attention. Among the resolutions adopted by the Conference were the following statements:²³

¹⁸ *Ibid.*, p. 139.

¹⁹ *Ibid.*, p. 128.

²⁰ Tax Committee of the Council of State Governments, *Postwar State Taxation and Finance*, (April 1947) cf. pp. 8-9.

²¹ See footnote 5.

²² *Op. cit.*, p. 139.

²³ Council of State Governments, *State Government* (Aug. 1947) "The Governors Conference," p. 225.

... the rules and regulations promulgated (in grant programs) are often lengthy, confusing and conflicting. It is primarily through the writing of rules and regulations by the Federal agencies that total authority and supervision are retained by the Federal Government. The Governors Conference therefore recommends that Federal aid legislation require Federal administrative agencies to confer with and secure approval from the Executive Committee of the Governors Conference in the preparation of rules and regulations governing the administration of Federal grants to the states.

Further development of this concern for greater state and local independence was evident in the Joint Conference of Representatives of the Congress of the United States and of the Governors Conference, a meeting of somewhat historic importance in the field of intergovernmental fiscal relations, which was held in Chicago, September 26-27, 1947. The Conference agreed that:²⁴

... our states must cease relying upon the Federal Government to do things for them ... which they can do for themselves as well as, or better than, the Federal Government.

The accomplishment of these objectives is largely dependent upon economy in government and the establishment of fiscal self-sufficiency among the various levels of government.

Although a detailed program to these ends was not developed, certain first steps were outlined. These were: to reduce federal excises with special consideration given local telephone calls, intra-state electrical energy, gasoline and admission taxes; and to amend inheritance and estate taxes for more equitable division with the states; and to relinquish to the states the portion of the employers tax retained federally for administrative purposes.

The attitude and recommendations of this Conference were later unanimously endorsed by the special Senate Subcommittee on Coordination of Federal and State Taxes. In discussing these recommendations, the Subcommittee's report, submitted by Senator Bricker April 2, 1948, said that the maintenance of a coordinated system of intergovernmental finance depends first on the determination of the overall total of public spending, second, on the division of total resources available for three-level governmental use, and third, on the appropriateness of the ways in which each level of government is to raise its funds. Here again were deliberations and

²⁴ Council of State Governments, *State Government* (November, 1947) p. 299.

recommendations leading up to, but not pursuing, the fundamental issue.²⁵

The correct answer . . . depends on the relative importance to the people as a whole of the functions and services devolving upon the Federal Government as compared to the importance of (those) devolving upon the States and localities.

There is at present, however, no regular procedure for weighing the national importance of each set of services against that of the other for the purpose of determining what proportion of the total tax resources . . . to allot to each.

The activities of the Council of State Governments, the Governors Conference, and various Congressional committees, which culminated over several years in Senator Bricker's report, were somewhat paralleled by the work of the Joint Committee of the American Bar Association, the National Tax Association, and the National Association of Tax Administrators, which was set up in 1941, and completed its report in 1947. Also, there was a certain kinship of attitude between these two separate sets of associated organizations; for, essentially they differed with the premise of the Groves-Gulick-Newcomer committee. Regarding that report, the Joint Committee said:²⁶

Its recommendations indicate a purpose to attack these problems in detail from many angles in such a manner that our Federal system of government will not be destroyed.

In our opinion there is danger in placing too much responsibility upon the Federal Government for tax coordination and not enough upon the states.

It is our earnest conviction . . . that if increasing centralization is not substantially diminished, the survival of our democracy will be gravely endangered.

The Joint Committee's report, which is the most recent document of any comprehensiveness and detail on intergovernmental fiscal relations, also differed with its major predecessor on general fiscal policy. The fundamental assumptions of the Joint Committee were: the sovereign powers of both federal and state governments should be preserved; each level of government should support its own functions from its own independent revenues; the government raising particular taxes should have control over their expenditure;

²⁵ Senate Report No. 1054, 80th Congress, 2nd Session, p. 5.

²⁶ *The Coordination of Federal, State, and Local Taxation* (1947) p. 2.

and, the primary purpose of taxation is to raise revenue, not to regulate or reform.

Although the Joint Committee's assignment was limited to the coordination of taxation, its position on a number of collateral matters was made clear. For example, "Before taxes can be coordinated it must be decided first what functions each grade of government should perform."²⁷ It should be noted that the Committee was the first study group to go beyond the mere statement of this fact. It felt that defense, of course, should remain as a federal function, along with some responsibility for aid to agriculture and other economic activities or services of national concern. States and localities should retain primary responsibility for education, social welfare, public health, crime control, highway service. In general, the allocation of function should be financed by a separation of sources, and if adequate separate sources are not possible, then functions for which revenue is lacking should be taken over and directly financed by the next higher level of government rather than supported by grants-in-aid. Tax sharing and supplements were similarly disapproved in favor of tax credits and deductions, and administrative cooperation, as better methods of coordination.

The Joint Committee's specific tax proposals follow:

FEDERAL

Individual Income Taxes: allow report of state income taxes on an accrual basis; equalize taxation in regard to community property laws; coordinate more effectively with state income taxes.

Corporate Income Taxes: develop more uniformity between federal and state taxes through administrative operation; tax state and local enterprises.

Death Taxes: withdrawal from this field of taxation.

Gift Taxes: repeal.

Gasoline Taxes: withdrawal from such taxation, including aviation fuel.

License Taxes: preferential use for aviation.

Tobacco Taxes: exclusive use.

Liquor Taxes: coordinate with state taxes; withdraw from license taxation; tax profits of state liquor stores.

Payroll Taxes: 100 percent federal credit for state unemployment taxes.

Sales Taxes: refrain from such.

Payment in lieu of Taxes: should be paid localities only when a tax basis is impractical.

Amusements, Admissions: withdrawal.

²⁷ *Ibid.*, p. 11.

STATE

Individual Income Taxes: disallow the deduction of federal income taxes; administrative cooperation with federal government to achieve uniformity of definitions and reasonable credits for taxes paid these states.

Corporate Income Taxes: allocate business income of interstate corporations on formula involving ratios of tangible property, sales, and payrolls in a given state to totals for the corporation; tax federal and local enterprises.

Death Taxes: exclusive use; uniform deductibility of contributions.

Gift Taxes: exclusive use; coordinate with death taxes.

Gasoline Taxes: exclusive use of state and local governments, with preferential use by states, interstate credits should be allowed.

License Taxes: exclusive use for motor vehicles with interstate credits for commercial vehicles; permissive use for aviation.

Tobacco Taxes: withdrawal from this field of taxation.

Liquor Taxes: administrative cooperation with federal government; license taxes; interstate credits for taxes paid elsewhere.

Sales Taxes: preferential, if not exclusive use; interstate cooperation to promote uniformity and equity.

Property Taxes: tend toward exclusive local use; assess directly all property not adaptable for local assessment; tax property used in aviation.

Amusements, Admissions: exclusive state and local use.

LOCAL

Income Taxes: avoid introducing such.

Gasoline Tax: discourage local use.

Liquor Taxes: restrict to license taxes.

Sales Taxes: avoid such taxes.

Property Tax: refine and improve; evaluate exemptions for possible withdrawal; tax federal property same as state and local and private property is taxed; tax federal and state enterprises.

Amusements, Admissions: strengthen use.

There has been no more succinct a statement of the major issues complicating intergovernmental fiscal relations than that introducing the summary of "Federal-State Relations," a task force report of The Commission on Organization of the Executive Branch of the Government, which was released in March 1949. These are:²⁸

1. The allocation of functions between the national government and the states.
2. Modifications in the nature, bases, and amounts of grants-in-aid to the states, and in the nature and amount of supervision and control by the national government over aided activities.

²⁸ *Op. cit.*, reprinted by Tax Foundation p. 2.

3. Adjustments in sources of revenue between the nation and the states in order that revenues available to each level will correspond more nearly with their fiscal needs.

The report of the Commission itself was extremely brief, although it carried recommendations on these points which will be cited later. However, the task force on federal-state relations, even in its summary report, was somewhat more explicit.²⁹

Although the task force considered complete separation of functions neither practical, possible, nor desirable, it suggested a general delineation. Federal functions should be only those designated or implied by the Constitution, demonstrated by necessity as national in character, and those within constitutional limits which cannot currently be effectively assumed by the states. These include: defense; foreign affairs; veterans' affairs; regulation of transportation facilities; immigration; interstate commerce; and certain standards for business practices; operation of the postal service; etc.

In addition to these primary responsibilities, federal functions may extend to programs such as farm price support, old age and survivors insurance, government lending and insurance corporations, and the development of labor standards. State activities should include those functions requiring state control and administration, such as matters of civil, criminal and property law; ordinary police and fire protection; education; public welfare and assistance; public health; employment security; housing and slum clearance. Although state activities should remain their own, this does not preclude federal cooperation or carefully devised grants-in-aid. But a balance of power is still the cardinal point in our system of government, and, as the task force specifically pointed out, there is "inherent danger" in the trend toward centralization.

In this regard it is significant that the task force also recommended certain *joint* functions in such areas as highways and public works construction, conservation of natural resources, and agricultural services. The principles specified for joint responsibility in public works also give evidence of attention to state sovereignty. For example, the national government should confine itself to

²⁹ It was intimated by the task force on Public Welfare that federal grants for public assistance might be abandoned. See the excerpts from that report cited in Chapter 9 herein.

projects of interstate or national importance and should not by-pass the states in financing local projects; joint functions mean joint planning, development and financing; federal funds advanced for public works benefitting a given locality should be recovered, so that the people of all states will not be financing improvements in certain localities.

However this attitude toward jurisdictional self-sufficiency was not carried over into the recommendations on grants-in-aid. The report endorsed the idea of grants varying with state per capita income as well as with population, a mechanism which does redistribute income from all states for the benefit of specific states. The major proposal in regard to grants was nevertheless one intended to strengthen the independence and responsibility of the states. This was to the effect that all the grants for social welfare and related programs be rescinded, and a single comprehensive grant for general purposes be substituted, the allocation of which, for given functions, would be completely under state control.

In regard to specific taxes, the report made several proposals designed to increase the ability of the states to finance their own functions. It was recommended that the federal government reduce or relinquish retail sales taxes, taxes on local telephone calls, admissions, club dues, safe deposit boxes, amusement devices, etc., which are especially for state and local purposes; that the estate and gift taxes be revised to provide a larger proportion of revenue to the states; that the federal tax on employers be made available to the states on an agreed formula, rather than on the discretionary basis now used, without stringent control and in order that the states can finance the administration of their own unemployment systems. No recommendations were made in regard to revision of excises other than those above mentioned, or of the income tax, "due to the heavy and uncertain present and prospective expenses of the national government."³⁰

In large part the report of the Commission itself bore out the suggestions of the task force, although there was dissent by Dean Acheson and the late James Forrestal to the entire report of the majority. As previously noted, the Commission's report was brief.

³⁰ *Ibid.*, p. 15.

It was also dissatisfyingly general. Perhaps its greatest significance lies in the fact that, like the report of the first study-group of this kind — The Interstate Commission on Conflicting Taxation, fourteen years earlier — it wound up by recommending:³¹

1. That the functions and activities of government be appraised to determine which can be most advantageously operated by the various levels of government, and which require joint policy making, financing and administration.
2. That our tax systems — National, State and local — be revised and that in this revision every possible effort be made to leave to the localities and the States adequate resources from which to raise revenue to meet their duties and responsibilities.

In fact, looking back over the studies and reports which have been made since the problems of intergovernmental fiscal relations were first put on record in 1933, it would seem that current activities were merely starting again the cycle of commissions to recommend studies, and studies to propose councils and committees. Early 1949 evidence of this was the two-day conference of sixteen government officials and nine representatives of interested national organizations to make a "specific beginning" on fiscal problems confronting the federal government and the states and localities. In calling the meeting for April 21-22, 1949, Secretary of the Treasury John Snyder stressed its "exploratory" nature. And in summing up the discussion he said the conference had "contributed much to the common appreciation of the problems involved." By 1950 Congress had before it a bill to create another commission to study these problems again. Since history on this subject seems to repeat rather than to resolve the problems, perhaps it is not unfitting to conclude with several still appropriate 1937 comments reviewing earlier work of the Interstate Commission and the Tax Revision Council.³²

Obviously, no progress has been made in reducing conflicting taxation, and the mad scramble for more and more revenue goes on.

... we are still in the committee stage of reports, re-statings of the tax problem, head-shakings over difficulties. Everything is stationary but the taxes!

Will 1950 find a self-governing people staggering under worse multiplied tax burdens, still only listening to reports about it and wishing "somebody would do something?"

³¹ The Commission on Organization of the Executive Branch of the Government, Overseas Administration, *Federal-State Relations*, Federal Research, p. 35.

³² Council of State Governments, *Book of the States*, Vol. 11, Book One, p. 83.

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